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2589

No. 12296

United States
Court of Appeals
For the Ninth Circuit.

E. R. GOOLD,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Transcript of Record

Upon Petition to Review a Decision of the Tax Court of the United States

Phillips & Van Orden Co., 870 Brannan Street, San Francisco, Calif.

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INDEX

[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in italic; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in italic the two words between which the omission seems to occur.]

INDEX PAGE

The Tax Court of the United States

Docket No. 15072

E. R. GOOLD,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Appearances:

For Petitioner:
Lafayette J. Smallpage
Frank C. Scott, C.P.A.

For Respondent:
Leonard A. Marcussen
R. C. Whitley

DOCKET ENTRIES

1947

June 30—Petition received and filed. Taxpayer notified. Fee paid.

July 1—Copy of petition served on General Counsel.

Aug. 6—Answer filed by General Counsel.

Aug. 6—Request for hearing in San Francisco, Calif., filed by General Counsel.

Aug. 12—Notice issued placing proceeding on San Francisco calendar. Service of answer and request made.

1948

Jan. 26—Hearing set March 22, 1948, San Francisco, California.

1948

Mar. 29—Hearing had before Judge Kern on merits.
and 30 All testifying witnesses excluded from Courtroom upon request of counsel for respondent. Record will be held open 30 days pending receipt of two partnership returns to be made a part of exhibit 10-J and 15-O; also to await balance sheets of E. R. Goold for 1944 thru 1946 and Goold, Downer & Zinck for 1942 thru 1946. Stipulation of facts with joint exhibits 1-A, 2-B and 3-C, motion to amend answer, amendment to answer and reply to amendment to answer filed at hearing. Copies served. Petitioner's brief due 6/1/48; respondent's brief due 7/1/48; petitioner's reply due 7/21/48.

Apr. 26—Transcript of hearing 3/29/48 filed.

Apr. 26—Transcript of hearing 3/30/48 filed.

May 4—Motion for leave to file exhibits 34-Z to 45-KK incl. filed. (Agreed). 5/5/48 Granted.

June 1—Brief filed by taxpayer. Copy served by taxpayer.

June 23—Motion for extension to Aug. 15, 1948 to file respondent's brief filed by General Counsel. 6/25/48 Granted.

Aug. 16—Motion for extension of time to Aug. 30, 1948 to file brief filed by General Counsel. 8/17/48 Granted.

1948

Sept. 3—Motion for leave to file the attached brief, brief lodged, filed by General Counsel. 9/7/48 Granted.

Sept.30—Motion for leave to file the attached reply brief, brief lodged, filed by taxpayer. 10/1/48 Granted. 10/4/48 Copy served.

1949

Jan. 6—Memorandum findings of fact and opinion rendered, Judge Kern. Decision will be entered under Rule 50. Served 1/7/49.

Feb. 7—Motion for reconsideration of opinion and attached memorandum in support thereof filed by taxpayer.

Feb. 9—Motion of Feb. 7, 1949 denied.

Feb. 17—Computation filed by General Counsel.

Feb. 23—Hearing set Mar. 23, 1949 on respondent's computation.

Mar. 23—Hearing had before Judge Turner, on settlement. Referred to Judge Kern.

Mar. 24—Acceptance of computation under Rule 50 filed by taxpayer. Copy served.

Mar. 28—Decision entered, Judge Kern, Div. 16.

June 24—Bond in the sum of $27,000.00 approved and ordered filed.

June 24—Petition for review by U. S. Court of Appeals for the Ninth Circuit with assignments of error filed by taxpayer.

June 24—Praecipe for record filed by taxpayer.

June 29—Proof of service of petition for review filed by General Counsel.

June 29—Proof of service of praecipe for record filed by General Counsel.

[Title of Tax Court and Cause.]

PETITION

The above-named petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency (IRA:90-D:DMR/C:TS:PD/SF:WOW) dated June 5, 1947, and as a basis for his proceeding alleges as follows:

1. The petitioner is an individual who resides at No. 1225 North Hunter Street, Stockton, California. The returns for the period here involved were filed with the collector for the first district of California.

2. The notice of deficiency (a copy of which is attached and marked Exhibit A) was mailed to the petitioner on June 5, 1947.

3. The taxes in controversy are income and victory taxes for the calendar year 1943 and in the amount of $18,849.65. The deficiency determined and asserted by the respondent Commissioner is $18,632.28, and the petitioner claims that he is entitled to a refund of not less than $217.37 in income and victory taxes overassessed on his return for the calendar year 1943, which amount was paid within three years before the execution (on February 26, 1947) of an agreement by both the respondent and the petitioner pursuant to section 276(b), Internal Revenue Code, to extend beyond the time prescribed in section 275, Internal Revenue Code, the time within which the respondent might assess the tax. See Exhibit B for computation of the refund claimed.

4. The determination of taxes set forth in the said notice of deficiency is based upon the following errors:

(a) In his determination of income tax net income and victory tax net income for the calendar year 1943 the respondent erroneously increased the petitioner's distributive share of ordinary income from the partnership, R. Goold and Son, $27,046.49, by including therein the community property moiety thereof taxed and taxable in the 1943 return of the petitioner's wife Elizabeth.

(b) In his determination of income tax net income and victory tax net income for the calendar year 1943 the respondent erroneously failed and refused to reduce the petitioner's community property moiety of his distributive share of ordinary income from the above-named partnership $355.94, i.e. from $30,258.37 to $29,902.43 (one-half of the corrected distributive share of $59,804.86 as determined and computed in the said notice of deficiency at pages 2 and 3 of the statement attached thereto).

(c) In his determination of income tax net income for the calendar year 1943 the respondent erroneously added to the petitioner's taxable income $131.31 to make his share of the net capital gain realized by the above-named partnership $262.61 as if it were his separate property whereas the said gain of $131.31 was properly included, taxed and taxable in the separate income tax return of the petitioner's said wife as her community property moiety of such net capital gain.

(d) In his determination of income tax net income and victory tax net income for the calendar year 1943 the respondent erroneously disallowed and failed and refused to allow a deduction of $300 as the petitioner's community property moiety of travel and entertainment expenses paid and incurred by the petitioner individually in and about the partnership business of R. Goold and Son in the total amount of $600 and properly claimed and deductible in the petitioner's and his said wife's returns.

(e) In his determination of victory tax net income for the calendar year 1943 the respondent erroneously failed and refused to allow as a deduction for accrued California personal income tax leviable and assessable upon the petitioner's distributive income of the partnership, R. Goold and Son, in the amount of $2,215.64 (according to the respondent's computation thereof), or $672.78 (according to the petitioner's computation thereof in Exhibit B), or any amount whatever.

(f) In his computation and determination of the petitioner's income tax for the calendar year 1943 the respondent erroneously failed and refused to allow the earned income credit of $590.65 as claimed and deducted in the petitioner's return for that year, or the corrected and allowable earned income credit of $618.04 as computed in Exhibit B hereunder, or the constructively allowable earned income credit of $1,190.76 deductible on the basis of the taxable income determined by the respondent, or

any earned income credit whatever in excess of the minimum of $300.

(g) In the alternative to specifications of error (a), (b) and (c) above, or any of them, the respondent, in determining the petitioner's income tax net income and victory tax net income for the calendar year 1943, erroneously failed and refused to eliminate, exclude and deduct from the petitioner's distributive share of the income of the partnership, R. Goold and Son, as the wife's moiety of community property income derived from and attributable to the petitioner's personal services in and about the business of the said partnership the sum of $26,928.41, or any amount whatever in excess of $2,500.

(h) In the alternative to specifications of error (a), (b) and (c) above, or any of them, the respondent, in determining and computing the petitioner's income tax for the calendar year 1943, erroneously failed, refused and neglected to apply and allow to the petitioner that part of the joint personal exemption, $687.50, and credit for dependents, $525.00, which had been claimed and deducted in the return of the petitioner's said wife, so as to result in the minimum aggregate tax liability for the two spouses when recomputed according to the respondent's concept or theory of the allocation of the taxable income.

5. The facts upon which the petitioner relies as the basis of this proceeding are as follows:

(a) At all time material to this proceeding the

petitioner was married to and living with his wife Elizabeth. At all times since his marriage to the said wife the petitioner has been domiciled in and a resident of the State of California. At the end of the calendar year 1943 there was issue of the marriage of the petitioner and his said wife three daughters, Beverly Ann, Meredith Elizabeth and Joan Kathleen, all of whom were under the age of eighteen years and dependent upon the petitioner and his said wife, and a son, Everett R., Jr., who had been born on June 29, 1943, who was likewise dependent upon the petitioner and his said wife.

(b) The petitioner and his father, R. Goold, were equal partners in a general contracting business conducted under the style of R. Goold and Son. The petitioner acquired his one-half interest in the said partnership on January 2, 1943, by purchase on the credit of his community property estate from his father, R. Goold, the petitioner's purchase money obligation being in the form of a note for $100,000, later corrected by endorsement to $70,741, without interest and payable out of the petitioner's share of future earnings at the rate of twenty-five percent or more of the annual profits.

(c) Endorsements of credits on the said note under dates of December 25, 1943, 1944, and 1945, in the aggregate of $24,000, by direction of the holder of the said note, R. Goold, the petitioner's father, as gifts were made with the intent and motive on the part of the said father to benefit the community property estate of the petitioner and his

wife Elizabeth and without any donative intent whatever toward the separate property estate of the petitioner or toward the petitioner in any manner except to benefit, increase and augment the said community property estate.

(d) The petitioner as a partner of the firm of R. Goold and Son paid and incurred expenses out of his own means and funds in and about the business of the firm and for the firm's benefit for the costs of travel, the entertainment of customers, suppliers and the like of the firm and for similar purposes in the sum of not less than $600 for the year 1943, no part of which was reimbursed to him then or thereafter by the said firm. All of the expenses so incurred and paid were ordinary and necessary expenses of the petitioner in his business of general contracting as a partner of R. Goold and Son and in connection with his earning of his share of the partnership income.

(e) The petitioner and his said wife were, as residents of California, subject for the calendar year 1943, and for all other periods material to this proceeding, to taxation of his and their income by the State of California under the provisions of the California Personal Income Tax Act (Stats. 1935, p. 1090) as amended (Stats. 1937, p. 1831; Stats. 1939, p. 2528; Stats. 1941, pp. 1226, 1275; and Stats. 1943, pp. 1040, 1467 and 1568) and they did duly file under the provisions of the said Act on official forms provided by the Franchise Tax Commissioner of the said State separate income tax returns for

the said calendar year in which the "net income" of each spouse was shown and returned in the amount of $30,261.59, and the income tax was computed, paid and assessed on each separate return in the amount of $690.58.

(f) The petitioner's total community property income from wages and salaries payable to and received by the petitioner during the calendar year 1943 was $690 and the net community property moiety thereof taxable on his separate income tax return, after deduction of California unemployment tax levied thereon, was $341.55. The amount of the petitioner's distributive share of the net profits of the partnership, R. Goold and Son, for the calendar year 1943 derived from and attributable to the petitioner's personal services in and about the business of the partnership was not less than $53,256.82 and a "reasonable allowance as compensation for personal services actually rendered" by the petitioner during the said calendar year to "be considered as earned income" for the purposes of sections 25(a)(3) and 25(a)(4), Internal Revenue Code, as in force and effect for the said calendar year, was not less than $11,677.74.

Wherefore the petitioner prays that this honorable Court may hear the proceeding and determine that he is not liable for any deficiency in income and victory taxes and, further, that he is entitled to a refund of an overassessment and overpayment of income and victory taxes in the amount of $217.34, and that taxes of such amount were paid

within three years before the execution of an agreement by both the respondent and the petitioner pursuant to section 276(b), Internal Revenue Code, to extend beyond the time prescribed in section 275, Internal Revenue Code, the time within which the respondent might assess the tax, and he further prays for such other relief as the Court may deem proper according to the evidence and the record in this proceeding.

/s/ LAFAYETTE J. SMALLPAGE.
/s/ FRANK C. SCOTT, C.P.A.,
Counsel for Petitioner.

State of California,
County of San Joaquin—ss.

E. R. Goold, being duly sworn, says that he is the petitioner above named; that he has read the foregoing petition, or had the same read to him, and is familiar with the statements contained therein, and that the statements contained therein are true, except those stated to be upon information and belief, and that those he believes to be true.

/s/ E. R. GOOLD.

Subscribed and sworn to before me this 16th day of June, 1947.

[Seal] HAZEL SMIKLE,
Notary Public in and for the said State and County.

EXHIBIT A

[Letterhead]

Treasury Department
Internal Revenue Service
74 New Montgomery Street
San Francisco 5, California

Office of
Internal Revenue Agent in Charge
San Francisco Division
IRS:90-D:DMR:(C:TS:PD:SF:WOW)

June 5, 1947

Mr. E. R. Goold
1832 Lomita Avenue
Stockton, California

Dear Mr. Goold:

You are advised that the determination of your income and victory tax liability for the taxable year ended December 31, 1943 discloses a deficiency of $18,632.28 as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiency or deficiencies mentioned.

Within 90 days (not counting Saturday, Sunday, or a legal holiday in the District Columbia as the 90th day) from the date of the mailing of this letter, you may file a petition with The Tax Court of the United States, at its principal address, Washington 25, D. C., for a redetermination of the deficiency or deficiencies.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward

it to the Internal Revenue Agent in Charge, San Francisco 5, California for the attention of Conference Section. The signing and filing of this form will expedite the closing of your return(s) by permitting an early assessment of the deficiency or deficiencies, and will prevent the accumulation of interest, since the interest period terminates 30 days after filing the form, or on the date assessment is made, whichever is earlier.

Very truly yours,
JOSEPH D. NUNAN, JR.;
Commissioner,
By /s/ F. M. HARLESS,
Internal Revenue Agent
in Charge.

Enclosures: Statement, Form of waiver, Form 1276.

Statement

San Francisco
IRA:90-D:DMR:(D:TS:PD:SF:WOW)

Mr. E. R. Goold
1832 Lomita Avenue
Stockton, California

Tax Liability for the Taxable Year Ended December 31, 1943.

	Deficiency
Income and Victory Tax	$18,632.28

In making this determination of your income and victory tax liability, careful consideration has been given to your protest executed September 20, 1945 and to the statements made at the conference held

on February 11, 1946, February 11, 1947 and March 28, 1947.

A copy of this letter and statement has been mailed to your representative, Mr. Lafayette J. Smallpage, Savings and Loan Bank Building, Stockton, California, in accordance with the authority contained in the power of attorney executed by you and on file with the Bureau.

STATEMENT FOR YEAR 1942

No change is made in income as reported on your joint return.
Tentative income tax liability reported..... $47.42

Statement

ADJUSTMENTS TO NET INCOME

Year: 1943

		Income Tax Net Income		Victory Tax Net Income
Net income as disclosed by return		$29,523.48		$29,660.22
Unallowable deductions and additional income:				
(a) Partnership income	$27,046.49		$27,046.49	
(b) Capital Gain	131.31		0.00	
(c) Other deductions	988.45		988.45	
		$28,166.25		28,034.94
Total		$57,689.73		$57.695.16
Nontaxable income and additional deductions:				
(d) Taxes		2,217.08		0.00
Net income as adjusted		$55,472.65		$57,695.16

EXPLANATION OF ADJUSTMENTS

(a) Partnership income from R. Goold and Son, Stockton, California, is increased by $27,046.49 as shown below:

Total ordinary income reported on partnership return	$121,033.49
Increase:	
(1) C. E. Kennedy	1,220.80
Total	$122,254.29
Decrease:	
(2) C. L. Wold, P. Midbust and Anderson and Ringrose	2,644.56
Partnership income as corrected	$119,609.73
Fifty percent distributive share	59,804.86
(3) Your separate and community share ($59,804.86—$2,500.00)	57,304.86
Amount reported on return	30,258.37
Adjustment—increase	$ 27,046.49

(1) Income from partnership of C. E. Kennedy is increased by $1,220.80 as follows:

(A) Cost of goods sold overstated	$ 3,139.37
(B) Salaries and wages overstated	523.04
Total increase	$ 3,662.41
Distributive share—33⅓%	$ 1,220.80

(A) It is disclosed that the total cost of materials purchased was $14,924.83 instead of $18,064.20 as claimed, a difference of $3,319.37.

(B) On the basis of records submitted, deduction for salaries and wages is reduced from $22,502.35 to $21,979.31, a decrease of $523.04.

(2) Income from C. L. Wold, P. Midbust and Anderson and Ringrose, a partnership, is decreased by $2,644.56 as follows:

Decrease:	
(A) Net profit overstated	$ 4,377.89
Increase:	
(B) Unreported travel and office expense allowance	1,733.33
Net decrease	$ 2,644.56

(A) Total profit of $535,836.45 on construction work completed during the years 1942 and 1943 is reallocated between the two years on the basis of contracts completed and accepted in 1942. The amount of $39,400.94 included in profits for 1943 is transferred to the taxable year 1942 as previously agreed to by you. Your one-ninth distributive share of profit overstated in 1943 is $4,377.89.

(B) Unreported reimbursement of $2,233.33 received for travel expense and office expense is considered as additional income from the partnership. However, a deduction of $500.00 is allowed from the above amount for traveling expenses made to Marysville in connection with construction work. Accordingly, income is increased by the net difference of $1,733.33.

(3) On or about January 2, 1943, you and your father entered into an agreement of co-partnership. At the same time your father transferred to you a one-half interest in Eddy Electrical and Mechanical Company, theretofore operated as a sole proprietorship, and one-half of his interest in several joint ventures, engaged in construction work, for your note of $100,000.00 without interest. Payments on said note were to be solely out of future profits and in a sum equal to twenty-five (25%) percent or more of the annual profits which shall be made to and received by you out of the operation of said business.

By an endorsement dated December 31, 1943, the note was credited with $50,000.00 described as "Credit by Error made in Computation of value of

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(B) Unreported reimbursement of $2,233.33 received for travel expense and office expense is considered as additional income from the partnership. However, a deduction of $500.00 is allowed from the above amount for traveling expenses made to Marysville in connection with construction work. Accordingly, income is increased by the net difference of $1,733.33.

(3) On or about January 2, 1943, you and your father entered into an agreement of co-partnership. At the same time your father transferred to you a one-half interest in Eddy Electrical and Mechanical Company, theretofore operated as a sole proprietorship, and one-half of his interest in several joint ventures, engaged in construction work, for your note of $100,000.00 without interest. Payments on said note were to be solely out of future profits and in a sum equal to twenty-five (25%) percent or more of the annual profits which shall be made to and received by you out of the operation of said business.

By an endorsement dated December 31, 1943, the note was credited with $50,000.00 described as "Credit by Error made in Computation of value of

Interest Sold." By endorsement dated January 17, 1947, the credit was changed to $29,259.00 in place of the above-mentioned $50,000.00. The note also bears endorsements dated December 25, 1943, December 25, 1944 and December 25, 1945, described as gifts and the sums of the gifts aggregate $24,000.00. An endorsement appears on said note dated January 25, 1947, described, "Earnings for 1945 $7,107.42."

The last-mentioned amount represents a payment made by you to your father out of your share of the partnership profits of 1945. On or about March 26, 1947, you delivered a bank check to your father in the amount of $3,040.04 purporting to represent payment out of 1946 profits. No payment has been made by you respecting the annual profits of the partnership for the years 1943 and 1944.

Your share of the profits amounted to approximately $60,000.00 in 1943 and $7,900.00 in 1944. You contend that your share of the income earned by the partnership is community income in its entirety, divisible equally between yourself and your wife. It is held that the circumstances herein, including the endorsements aggregating $24,000.00 described as gifts and the omission of payments out of profits of the years 1943 and 1944 signify that your father did not intend to enforce payment of the note with the consequence that the transaction whereby you acquired a one-half interest from him is in the nature of a gift and your share of the income of the partnership for 1943 is taxable to you as your separate income except $5,000.00 which is regarded as

the fair value of your services and constitutes community income.

(b) You and your wife each reported one-half of net capital gain of $262.61 from the partnership of R. Goold and Son. It is held that the above-mentioned gain is taxable to you in full as your separate property, and accordingly, your income is increased by $131.31.

(c) Other deductions claimed in the amount of $988.45 are disallowed as follows:

(1)	Entertainment expenses	$300.00
(2)	State income taxes	688.45
	Total disallowed	$988.45

(1) Entertainment expenses deducted in the amount of $300.00 in connection with partnership business are disallowed for the reasons that evidence has not been submitted establishing the expenditures as ordinary and necessary business expenses and amounts of such expenditures have not been substantiated.

(2) Deduction of $688.45 for California state income tax attributable to business income is eliminated since accrued state income tax on your total income is allowed under item (d) below.

(d) Deduction for accrued state income tax is increased by $2,217.08 as computed below:

Total income subject to state income tax (including net capital gain of $525.22 at 100%)		$57,953.47
Less:		
Personal exemption	$3,500.00	
Dependents	800.00	4,300.00
Balance subject to tax		$53,653.47

Tax on $30,000.00	$ 800.00
Tax on $23,653.47	1,419.21
Total state income tax accrued	$ 2,219.21
Amount deducted on return	2.13
Adjustment—increase	$ 2,217.08

(e) Earned income credit of $300.00 is allowed as follows:

Partnership earned net income	$ 5,000.00
Salaries	683.10
Total earned net income	$ 5,683.10
Your one-half share	$ 2,841.55
Earned income credit allowed (minimum)	$ 300.00

COMPUTATION OF ALTERNATIVE TAX
Year: 1943

Net income		$55,472.65
Less:		
Net long-term capital gain		262.61
Ordinary net income		$55,210.04
Less:		
Personal exemption	$512.50	
Credit for dependents	700.00	1,212.50
Surtax net income		$53,997.54
Less:		
(e) Earned income credit		300.00
Income subject to normal tax		$53,697.54
Normal tax at 6% on $53,697.54		$ 3,221.85
Surtax on $53,997.54		25,878.38
Partial tax		$29,100.23
Add:		
50% of excess of net long-term capital gain over net short-term capital loss		$ 131.31
Alternative tax		$29,231.54

COMPUTATION OF TAX
Year: 1943

Income tax net income		$55,472.65
Less:		
Personal exemption	$ 512.50	
Credit for dependents	700.00	1,212.50
Surtax net income		$54,260.15
Less:		
Earned income credit		300.00
Balance subject to normal tax		$53.960.15
Normal tax at 6% on $53,960.15		$ 3,237.61
Surtax on $54,260.15		26,051.70
Total income tax		$29,289.31
Total alternative tax		$29,231.54
Total income tax		$29,231.54
Victory tax net income	$57,695.16	
Less:		
Specific exemption	624.00	
Income subject to victory tax	$57,071.16	
Victory tax before credit (5% of $57,071.16)	$ 2,853.56	
Less:		
Victory tax credit	700.00	
Net victory tax		2,153.56
Income and victory tax for 1943		$31,385.10
Income tax for 1942 (½ of $47.42)		$ 23.71
Amount of 1942 or 1943 tax, whichever is larger		$31,385.10
Forgiveness feature:		
Amount of 1942 or 1943 tax whichever is smaller	$ 23.71	
Amount forgiven	23.71	
Amount unforgiven		0.00
Correct income and victory tax liability		$31,385.10

Income and victory tax disclosed by return; page 4—line 20 (Original, Account No. 901274, June 1944 List—First California District)	$12,752.82
Deficiency of income and victory tax	$18,632.28

EXHIBIT B OF PETITION

Statement of Overpayment Claimed for Refund

I. Net Income

		Income Tax Net Income	Victory Tax Net Income
	Income		
1.	Salaries and wages	$ 341.55	$ 341.55
2.	Dividends	17.50	17.50
4(b)	Interest on Government obligations	31.25	31.25
6(a)	Capital gain	131.30	.....
9.	Income from partnership	29,902.43	29,902.43
10.	Total income	$30,424.03	$30,292.73
	Deductions		
11.	Contributions	$ 52.50	.....
12.	Interest	149.75	.....
13.	Taxes	736.44	$ 670.68
16.	Other deductions, business expense	300.00	300.00
17.	Total deductions	$ 1,238.69	$ 970.68
18.	Income tax net income	$29,185.34	
19.	Victory tax net income		$29,322.05

Explanation of Items

Items 1, 2, 4(b) and 6(a). Per petitioner's income tax return unchanged.	
Item 9. Corrected distributive share of ordinary income per Exhibit A above (pages 2 and 3 of Statement	$59,804.86
Community property moiety taxable to petitioner	29,902.43
Items 11 and 12. Per petitioner's income tax return unchanged.	
Item 13. Personal taxes per petitioner's income tax return	$ 63.66
California income tax per Exhibit B-1 below	672.78
Total for income tax net income	$ 736.44
California income on business per allocation in Exhibit B-1 below, $670.68 for victory tax net income.	
Item 16. Travel and entertainment expense as claimed in petitioner's income tax return.	

II. Computation of Tax and Overpayment Claimed

1. Income net income per item 18, Section I		$29,185.34
2. Less capital gain		131.30
3. Balance, ordinary net income		$29,054.04
4. Less: Personal exemption	$512.50	
Credit for dependents	700.00	1,212.50
6. Balance, surtax net income		$27,841.54
7. Less earned income credit as computed below		618.04
8. Balance subject to normal tax		$27,223.50
9. Normal tax at 6 percent		$ 1,633.41
10. Surtax on $27,841.54		10,032.85
11. Tax on capital gain, $131.30 at 50 percent		65.65
12. Total income tax		$11,731.91
13. Victory tax as computed below		803.54
14. Total tax on 1943 income		$12,536.06
15. Tax on 1942 income		0.00
16. Total tax liability		$12,535.45
17. Income and Victory Tax disclosed by return (account No. 901274, June 1944 list, First Dist. of Calif.) and paid in full		12,752.82
18. Difference, overpayment claimed for refund		$ 217.37

III. Earned Income Credit

1. Ordinary net income partnership per item 9, Section I		$29,902.43
2. Business capital gain, item 6(a), Sec. I, $131.30 × 2		262.60
3. Total		$30,165.03
4. Less: travel and entertainment expense, item 16, Section I	$300.00	
5. Accrued California income tax on business per Exhibit B-1	670.68	970.68
6. Difference net profit from business		$29,194.35
7. Amount attributable to personal services		$26,628.41
8. Limitation on amount to be considered as earned income 20 per cent of $29,194.35		$ 5,838.87
9. Salaries and wages per item 1, Section I		341.55
10. Total earned income		$ 6,180.42
11. Earned income credit at 10 percent		$ 618.04

IV. Victory Tax Computation

1. Victory tax net income per item 19, Section I	$29,322.05
2. Less specific exemption	624.00
3. Balance subject to tax	$28,698.05
4. Victory tax at 5 percent	$ 1,434.90
5. Credit at 44 percent	631.36
6. Difference, net victory tax	$ 803.54

Exhibit B-1: Computation of Corrected California Income Tax for 1943, and Allocation

Income		
1. Salaries and wages		$ 341.55
2. Dividends		17.50
9. Partnership R. Goold & Son		30,112.51
12. Total income		$30,471.56
Deductions		
13. Contributions	$ 52.50	
14. Interest	149.75	
15. Taxes	63.66	
16. Other deductions, business expense	300.00	
20. Total deductions		565.91
21. Net income		$29,905.65
23. Less: personal exemption	$1,050.00	
credit for dependents	1,400.00	2,450.00
25. Balance subject to tax		$27,455.65
Tax on $25,000	$ 550.00	
Tax on balance, $2,455.65 @ 5%	122.78	
Total tax		$ 672.78
Tax on business income ($30,112.51—$300) 29,812.51/29,905.65 of $672.78		670.68
Balance, tax on non-business income		$ 2.10

[Endorsed]: Filed T. C. U. S., June 30, 1947.

[Title of Tax Court and Cause.]

ANSWER

Comes now the Commissioner of Internal Revenue, respondent above named, by his attorney,

Charles Oliphant, Acting Chief Counsel, Bureau of Internal Revenue, and for answer to the petition filed by the above-named petitioner, admits and denies as follows:

1 and 2. Admits the allegations contained in paragraphs 1 and 2 of the petition.

3. Admits that the taxes involved are income and victory taxes for the calendar year 1943, that the deficiency determined and asserted by the respondent is $18,632.28, and that the petitioner claims that he is entitled to a refund of not less than $217.37; denies the remaining allegations contained in paragraph 3 of the petition.

4 (a) to (h), inclusive. Denies the allegations of error contained in subparagraphs (a) to (h), inclusive, of paragraph 4 of the petition.

5 (a). For lack of knowledge or information sufficient to form a belief, denies the allegations contained in subparagraph (a) of paragraph 5 of the petition.

(b). Admits that petitioner and his father, R. Goold, were equal partners in a general contracting business conducted under the style of R. Goold and Son and that petitioner acquired his one-half interest in the said partnership on January 2, 1943, from his father, R. Goold, to whom petitioner gave a note for $100,000, later changed by endorsement to $70,741, without interest and payable out of the petitioner's share of future earnings at the rate of twenty-five per cent or more of the annual profits; denies the remaining allegations contained in subparagraph (b) of paragraph 5 of the petition.

(c). Admits that endorsements of credits on the said note under dates of December 25, 1943, 1944, and 1945, in the aggregate of $24,000, by direction of the holder of the said note, R. Goold, the petitioner's father, were made as gifts; denies the remaining allegations contained in subparagraph (c) of paragraph 5 of the petition.

(d) and (e). For lack of knowledge or information sufficient to form a belief, denies the allegations contained in subparagraphs (d) and (e) of paragraph 5 of the petition.

(f). Denies the allegations contained in subparagraph (f) of paragraph 5 of the petition.

6. Denies each and every allegation contained in the petition not hereinbefore specifically admitted, qualified, or denied.

Wherefore, it is prayed that the Commissioner's determination be approved and the petitioner's appeal denied.

/s/ CHARLES OLIPHANT,
Acting Chief Counsel, Bureau
of Internal Revenue.

Of Counsel:
B. H. NEBLETT,
Division Counsel.
T. M. MATHER,
LEONARD A. MARCUSSEN,
Special Attorneys,
Bureau of Internal Revenue.

[Endorsed]: Filed T.C.U.S. Aug. 6, 1947.

[Title of Tax Court and Cause.]

AMENDMENT TO ANSWER

Leave of the Court having first been obtained,

Comes now the Commissioner of Internal Revenue, respondent above named, by his attorney, Charles Oliphant, Chief Counsel, Bureau of Internal Revenue and amends, his answer to the petition filed by the above-named petitioner by adding thereto the following allegations:

7 (a). Petitioner filed his 1943 Federal income and victory tax return on the accrual and calendar year basis and claimed a deduction for personal income tax payable to the State of California for said year in the amount of $690.58 from income tax net income and $688.45 from victory tax net income.

(b). Respondent in his notice of deficiency erroneously allowed a deduction for said personal income tax payable to the State of California in the amount of $2,219.21.

(c). On or about June 13, 1944, petitioner duly filed with the Franchise Tax Commissioner of the State of California a personal income tax return as required by the California law showing a liability for California personal income tax for the calendar year 1943 in the amount of $690.58, which amount petitioner paid.

(d). On or about October 24, 1947, the office of the Franchise Tax Commissioner sent petitioner a formal Notice of Additional Personal Income Tax

Proposed to Be Assessed, showing a proposed additional assessment in the amount of $1,484.51.

(e). Petitioner duly filed with the Franchise Tax Commissioner a protest against the proposed additional assessment contesting his liability for the payment thereof. Petitioner has not paid the proposed additional assessment and continues to contest his liability for the same.

Wherefore, respondent prays that the Court redetermine the deficiency herein to be the amount determind by the Commissioner, viz., $18,632.28, plus an increased deficiency in the amount of $1,100.61, claim for which is hereby made pursuant to the provisions of section 272(e) of the Internal Revenue Code.

/s/ CHARLES OLIPHANT,
Chief Counsel, Bureau of
Internal Revenue.

Of Counsel:
B. H. NEBLETT,
Division Counsel.
T. M. MATHER,
Special Attorneys,
LEONARD A. MARCUSSEN,
Bureau of Internal Revenue.

[Endorsed]: Filed T.C.U.S. Mar. 29, 1948.

[Title of Tax Court and Cause.]

REPLY TO AMENDMENT TO ANSWER

Now Comes the petitioner, E. R. Goold, by his counsel as undersigned and for reply to the amendment to answer filed in this proceeding on behalf of the respondent Commissioner pleads as follows:

7(a). Admits the allegations contained in paragraph 7(a) of the amendment to answer.

7(b). Denies the allegation contained in paragraph 7(b) of the amendment to answer.

7(c) and (d). Admits the allegations contained in paragraphs 7(c) and 7(d) of the amendment to answer.

7(e). Admits that the petitioner duly filed with the said Franchise Tax Commissioner a protest against the proposed assessment described in paragraph 7(d) of the amendment to answer but denies the remaining allegations in the said paragraph 7(e) except to the extent and in the manner in which they are confirmed by the true copy of the said protest attached to and made a part of this reply and marked Exhibit A.

8. The petitioner denies generally and specifically each and every other allegation or implication in the said amendment to answer against the interest of the petitioner not hereinbefore qualified or denied.

Wherefore the petitioner prays that this honorable Court may hear the proceeding and determine that he is not liable for any deficiency in income

and victory taxes and, further, that he is entitled to a refund of an overassessment of income and victory taxes in the amount of $217.34 as prayed in his petition, and for such other relief as the Court may deem proper according to the evidence and the record in this proceeding.

/s/ LAFAYETTE J. SMALLPAGE,
/s/ FRANK C. SCOTT, C.P.A.,
Counsel for the Petitioner.

EXHIBIT A

Of Reply to Amendment to Answer

From the office of Frank C. Scott, Certified Public Accountant, Stockton, California.

Nov. 5, 1947.

Subject: Protest of E. R. Goold against proposed additional personal income tax for 1943.

Hon. Charles J. McColgan
Franchise Tax Commissioner
No. 1020 N Street
Sacramento 14, California

Dear Mr. McColgan:

This is to protest the additional personal income tax proposed by your Form 830 notice No. 87023, dated October 24, 1947, to be assessed on the Form 540 income tax return Serial No. 2,617,067 of E. R. Goold, who resides at No. 1225 North Hunter Street, Stockton, California, for the calendar year 1943. The entire amount of the proposed tax, $1,484.51, is in dispute, it being contended that the protest-

ant is entitled to a refund of $17.80 in personal income tax overpaid according to his Form 543 claim for refund filed contemporaneously herewith.

The adjustments productive of the proposed tax to which exception is taken are as follows:

(a) The transfer to the protestant's return of $27,256.58 in income from the partnership of R. Goold & Son from the return of his wife, Elizabeth, as not being community property income properly on his wife's return; and

(b) The disallowance of $300 deducted as entertainment expense in connection with the protestant's partnership business.

The grounds upon which the protestant relies as to the exceptions taken are as follows:

A: Community Property Income from Partnership.

The determination that only $5,000 of the protestant's corrected share of income from the partnership, R. Goold & Son, was community property income is based upon erroneous facts and premises and erroneous conclusions as to the pertinent laws of California pertaining to community property and gifts to community property estates. The correct facts and the only ones pertinent to the matter here at issue are as follows:

At all times material to this proceeding the petitioner was married to and living with his wife Elizabeth. At all times since his marriage to the said wife the petitioner has been domiciled in and a resident of the State of California.

The petitioner and his father, R. Goold, were equal partners in a general contracting business conducted under the style of R. Goold and Son. The petitioner acquired his one-half interest in the said partnership on January 2, 1943, by purchase on the credit of his community property estate from his father, R. Goold, the petitioner's purchase money obligation being in the form of a note for $100,000, later corrected by endorsement to $70,741, without interest and payable out of the petitioner's share of future earnings at the rate of twenty-five per cent or more of the annual profits.

Endorsements of credits on the said note under dates of December 25, 1943, 1944, and 1945, in the aggregate of $24,000, by direction of the holder of the said note, R. Goold, the petitioner's father, as gifts were made with the intent and motive on the part of the said father to benefit the community property estate of the petitioner and his wife, Elizabeth, and without any donative intent whatever toward the separate property estate of the petitioner or toward the petitioner in any manner except to benefit, increase and augment the said community property estate.

Assuming that the foregoing statement of facts is true, it is apparent that determination of a limited community property interest in the partnership assets and the partnership profits is without foundation. The facts are susceptible of proof and will be proven by proper and competent evidence in the pending proceeding before The Tax Court of the

United States under its docket number 15072 in which an identical determination for Federal income tax purposes is at issue.

It is suggested that the question here be settled on the basis of The Tax Court's findings in the cited proceeding.

B: Disallowance of Entertainment Expense.

This issue is entirely a question of fact, and an identical disallowance is at issue in the above cited proceeding pending before The Tax Court. In that proceeding it is intended to prove that the protestant as a partner of the firm of R. Goold and Son paid and incurred expenses out of his own means and funds in and about the business of the firm and for the firm's benefit for the costs of travel, the entertainment of customers, suppliers and the like of the firm and for similar purposes in the sum of not less than $600 for the year 1943, no part of which was reimbursed to him then or thereafter by the said firm; and, further, that all of the expenses so incurred and paid were ordinary and necessary expenses of the petitioner in his business of general contracting as a partner of R. Goold and Son and in connection with his earning of his share of the partnership income.

It is suggested that the question here at issue also be settled on the basis of The Tax Court's findings in the cited proceeding.

Conclusion.

In view of the suggestions above that the findings of The Tax Court of the United States on

issues identical with those raised in the exceptions stated above, but with respect to the protestant's Federal income tax liability, be accepted as basis for settlement of this protest, it is not desired that an oral hearing be granted for the consideration of this protest, but if you should decide not to follow these suggestions the protestant would, of course, desire to have an oral hearing at which he might present evidence in support of the facts stated above as grounds for his exceptions.

Respectfully,
/s/ E. R. GOOLD.

A true copy:
/s/ FRANK C. SCOTT, C.P.A.
Post Office Box No. 1904,
Stockton 100, California.

[Endorsed]: Filed T.C.U.S. Mar. 29, 1948.

[Title of Tax Court and Cause.]

MEMORANDUM FINDINGS OF FACT AND OPINION

This proceeding involves a deficiency in income and victory tax for the calendar year 1943 in the amount of $18,632.28, set forth in the deficiency notice, plus an increase of $1,100.61 claimed by respondent in an amendment to his answer, the total deficiency being in the sum of $19,732.89. Petitioner claims an overpayment of $217.37.

The principal issue is whether petitioner's share in the net income of the partnership of R. Goold & Son was his community or separate income. This, in turn, depends upon whether the interest in the partnership was acquired by petitioner from his father, the other partner, by purchase, as petitioner contends, or by gift, as respondent urges.

If the principal issue is decided in favor of respondent, two additional questions arise:

1. The amount of petitioner's distributive share of the partnership income attributable to his personal services, respondent allowing $5,000 therefor and considering the remainder as petitioner's separate income;

2. The propriety of respondent's action in refusing to change the amounts of personal exemption and of credit for dependents from that claimed by petitioner on his return, after the reallocation of the income.

Four subordinate issues are also presented:

1. The amount, if any, of deductible traveling and entertainment expenses claimed by petitioner on his return in the amount of $300;

2. The proper amount allowable as a deduction for personal income tax payable to the State of California, in computing Federal income tax liability;

3. The propriety of respondent's action in disallowing entirely for purposes of victory tax computation a deduction for the California personal income tax;

4. The amount of earned income credit to which petitioner is entitled.

Some of the facts have been stipulated.

FINDINGS OF FACT

The stipulated facts are hereby found accordingly and are incorporated herein by reference.

At all times material to this proceeding petitioner was a resident of Stockton, California, was married, and was the father of four minor children. One was born on June 29, 1943; the others were under eighteen years of age in 1943.

His tax return for the year involved, prepared on a calendar year-accrual basis, was filed with the collector for the first district of California. He reported his income and deductions on the community property method.

On January 2, 1943, petitioner and his father, R. Goold, entered into a partnership under the firm name of R. Goold & Son for the purpose of operating a business which petitioner's father had theretofore conducted as a sole proprietorship. On that date the father executed a bill of sale, whereby it was sought to transfer to petitioner an undivided one-half interest in all of the former's business assets described in the document, as follows:

A.	Eddy Electric and Mechanical Company. Assets valued at.....	$32,560.83
B.	An undivided one-half interest in the R. Goold and A. E. Downer joint venture as shown upon the book of accounts	51,496.04

C.	An undivided one-half interest in the R. Goold and F. R. Zinck joint venture as shown upon the book of accounts	$10,115.09
D.	An undivided one-half interest in the R. Goold and A. R. Liner joint venture as shown upon the book of accounts	2,500.00
E.	An undivided one-half interest in the R. Goold and C. L. Wold joint venture as shown upon the book of accounts	25,000.00
F.	An undivided one-half interest in the "Marysville" Contract as shown upon the book of accounts	40,000.00
	Total	$161,671.96

The property so described was owned prior to the transfer by petitioner's father and mother as their community property. In addition, they owned other community property of a value in excess of $83,000. They were the parents of another child, a daughter, who was two years older than petitioner.

The recited consideration for the transfer of the one-half interest was the execution and delivery by petitioner of a non-interest bearing note in the amount of $100,000, payable at the rate of "twenty-five (25%) per cent or more of the annual profits which shall be made to and received by me out of the operation of said business."

At the time of this transaction with his father, petitioner owned a small home, an automobile, and four shares of stock of the Union Oil Co.

Item A of the bill of sale represented the value of the assets of the Eddy Co., which was engaged in the business of the installation of wiring systems and the sale of electrical materials, supplies, and appliances. Items B to F, inclusive, consisted of the known and estimated share of the profits of petitioner's father in certain joint ventures for the performance of various Government contracts in the general area of Stockton, California. Petitioner's father received his share of the profits in each of the joint ventures primarily for undertaking the responsibility of financing them in whole or in part. Such financing as was necessary had been arranged and completed by petitioner's father prior to January, 1943. The accounting and handling of money for the joint ventures was done in the office of petitioner's father in order to safeguard his interests in connection with their financing.

The documents incident to the January, 1943, transaction were drafted and the terms and conditions determined by Lafayette J. Smallpage, an attorney, by whom, together with Frank Scott, an accountant, the entire arrangement was devised, after consultation with petitioner's father. The attorney determined that the face amount of the note should be in the sum of $100,000, that no interest should be payable, and that the manner of repayment should be as recited in the note.

The note contained the following endorsements on the back, all being in the handwriting of the attorney except those for 1944 and 1945, which were in the handwriting of the accountant:

12/25/43	Gift	3,000.00
12/31/43	Credit by Error made in Computation of Value of Interest Sold	50,000.00
	Changed per authority of Smallpage 1/17/47	29,259.00
12/25/44	By gift	3,000.00
12/25/45	By gift	18,000.00
1/25/47	Earnings for 1945	7,107.42

At the time of the execution of the note and the bill of sale it was understood between petitioner and his father that items E and F on the bill of sale, totaling $65,000, were round figures representing an estimate of the father's share of the profits in the so-called Wold joint ventures, and that the figure would be subject to adjustment when the profits were known, with a corresponding adjustment to be made on petitioner's note.

The corrected figure was determined to be $44,-810.04, which involved a decrease of $20,189.96, one-half of which in the amount of $10,094.98 was included in the adjustments endorsed upon the note on January 17, 1947. That endorsement was in the sum of $29,259.

Both petitioner and his father were unfamiliar with the purpose and reasons for the various en-

dorsements except that they did recognize that part of one endorsement was for the purpose of making the downward adjustment for profits from the Wold joint venture.

At the time of the transaction and for some years prior thereto, petitioner's father was not in good health and desired to bring petitioner into the business. This matter had been the subject of discussions for some time between petitioner and his parents and between his father and his mother. It was planned that petitioner would first work in the business as an employee for a few years in order to determine whether he could undertake the responsibilities incident to partnership. Upon the establishment of his worth as an employee, his father then intended to offer him a partnership interest, which he did in 1943.

The primary reason for having petitioner execute the note at the time of the creation of the partnership was to fulfill his father's wish to deal fairly and equitably with both petitioner and his sister, in so far as their distributive shares in their father's estate were concerned. It was intended that the balance remaining due on the note, together with adjustments for gifts made by the father, was to be deducted from petitioner's share in his father's estate in order to equalize the interest that petitioner and his sister would receive upon their father's death.

Petitioner's share of the partnership business was not acquired by purchase.

During 1943 petitioner received from the partnership a drawing account of $200 per week, which represented a partial distribution of profits. He received no other profit distributions from the business in that year.

Petitioner is a graduate of the College of the Pacific, by which he was awarded a Bachelor of Arts degree in 1934. Following his graduation and for two years thereafter he worked at various service stations, part of the time as an employee and part of the time in business for himself. His earnings during this period averaged about $150 per month. From 1936 to 1940 he was employed by the Union Oil Co., earning at the termination of this employment $165 per month. In 1940 petitioner commenced working for his father at the Eddy Co. In that year, his father purchased the interest of the other partner, thereby creating an opportunity for petitioner to join the business. Although not an electrician, petitioner familiarized himself with the details of the business and gradually assumed general responsibility for its operations. At those periods when his father was away because of illness, petitioner alone ran the business. He first received a salary of $40 weekly which was later increased to $50 weekly. In 1941 he received some instruction from Downer on the methods and problems incident to the laying of sewers, and in 1942 was employed by the Goold & Downer joint venture at a salary of $150 weekly to assist in that type of work. Such compensation was in addition to his salary from the Eddy Co.

During the taxable year petitioner devoted all of his time to partnership business. His activities consisted principally of the supervision of the electrical house-wiring work of the Eddy Co., and the supervision of workers and the general management of some of the joint-venture activities.

From 1942 to 1944 the partnership handled between six and seven million dollars worth of business. Petitioner was generally familiar with substantially all of the undertakings and participated in most of them.

The reasonable value of petitioner's personal services to the partnership in 1943 was $10,000, which is also a reasonable allowance as compensation for such personal services as he rendered to the business.

On his 1943 tax return petitioner reported total income for income tax purposes of $30,779.97, of which $30,258.37 was said to represent income from the partnership. He received salary and wages of $683.10 during the year and reported one-half thereof on his return.

On his 1943 tax return, petitioner claimed $512.50 of the total exemption of $1,200 allowable for husband and wife. He also claimed a credit of $700 for dependents, listing two daughters as dependents. Respondent has allowed these amounts in the deficiency notice.

He claimed as a deduction on the return $300 for entertainment and traveling expenses, representing his one-half of a total claimed expenditure of $600, alleged to have been incurred in partnership business.

A portion of the deduction was said to cover expenses incurred for luncheons and dinners for inspectors and Government officials, interested in the various projects being constructed under the joint venture agreements. The remainder was to cover cost of gas and oil for trips made by petitioner in his personal car. On many trips a company car was used, and at all times gas and oil was available for company business at the company pumps, which petitioner used in his personal car.

Petitioner kept no records of any of these expenditures, and the amount deducted was estimated by the accountants. There was no agreement between petitioner and his father as to the method of handling expenses incurred in the partnership business, and he did not seek reimbursement from the partnership, although some portion may have been reimbursed by the partnership.

On his 1943 return, petitioner also claimed a deduction for personal income tax payable to the State of California in the amount of $690.58 in computing income tax net income, and $688.45 in computing victory tax net income. In his notice of deficiency, respondent allowed a deduction in the amount of $2,219.21 in the computation of income tax net income, but allowed no deduction for the item in the computation of victory tax net income.

On or about October 24, 1947, the office of the Franchise Tax Commissioner of the State of California sent petitioner a formal notice of additional personal income tax proposed to be assessed, show-

ing a proposed additional assessment in the amount of $1,484.51. Petitioner duly filed with the Franchise Tax Commissioner a protest against the proposed additional assessment, contesting his liability for payment thereof. Petitioner has not paid the proposed additional assessment and continues to contest his liability for the same.

On his tax return petitioner claimed an earned income credit of $590.65. In the deficiency notice respondent allowed the minimum earned income credit of $300. This minimum allowance resulted because of respondent's determination that the reasonable value of petitioner's services to the partnership was only $5,000.

OPINION

Kern, Judge: In transactions between closely-related members of a family where tax liability is sought thereby to be affected "the statements, acts, and circumstances must all be considered and subjected to special scrutiny," James L. Robertson, 20 B.T.A. 112, 114. The mere self-serving statements of interested parties are not controlling as to the realities of the transactions. Frank J. Lorenz, 3 T.C. 746, 751; affirmed, 148 Fed. (2d) 527. The first issue in this proceeding, involving the question of whether petitioner acquired the one-half interest in his father's business assets by purchase or by gift, presents such a situation, and must be determined on all of the facts and circumstances shown by the record and not merely on the statements of petitioner and his father.

Petitioner argues that the transaction is accurately portrayed by the formal instruments executed incident thereto, such as the execution of the bill of sale and the note. Respondent urges that the principle underlying Gregory v. Helvering, 293 U. S. 465, calling for a realistic approach to tax problems, by viewing actual substance and not mere form, must lead to the conclusion that the acquisition was in reality by gift and not by purchase. We believe that petitioner has not overcome the presumptive correctness of respondent's determination, and that the record, in fact, supports respondent's position.

The facts incident to the transaction will not warrant a conclusion that the arrangements between petitioner and his father constituted a bona fide sale. The transaction does not appear to be one "that parties dealing at arm's length would have formulated." Granberg Equipment, Incorporated, 11 T. C. No. 85 (Oct. 28, 1948). Such factors as the absence of interest, the vague and unexplained endorsements on the note, and the failure to make any payments on the note in the first few years, the only substantial offsets being in the form of gifts, undermine the result petitioner wishes us to reach.

Even the testimony of the interested parties fails to persuade us that form should prevail. The whole program was designed by an attorney and by an accountant, and neither petitioner nor his father in testifying at the hearing herein could unravel many of the important details of the arrangements. None of the endorsements upon the note was made by them and none could be adequately identified.

Perhaps the best explanation of the transaction can be inferred from the testimony of petitioner himself. His father did not wish to prefer him over his sister in the ultimate distribution of the father's estate. While the transfer of the interest in the business was in reality a gift to the son in the nature of an advancement of an inheritance or legacy, a note was executed by the son, which was not intended by the parties to be evidence of a presently-enforceable debt arising out of a business transaction, but to be evidence of an advancement and which would serve as a means of equalizing, as between petitioner and his sister, the share of the father's estate which he would receive upon the latter's death.

Since it is our judgment that petitioner did not in reality acquire the interest in the business by purchase, but rather by gift, it accordingly follows that his interest was his separate property, and that the income therefrom was his separate income, except as to such part as is properly attributable to his own personal services. Cal. Civ. Code, Sections 163, 164, 687.

Respondent determined that the value of petitioner's personal services was $5,000, and that only that amount constituted community income. Petitioner contends that respondent erred in asserting the value of his services to be only $5,000. He contends further that additional error was committed in not determining that all of the income was community income except for a small allowance for in-

terest on petitioner's investment, as was done in Lawrence Oliver, 4 T. C. 684, and in Ashley Manning, 8 T. C. 537, or, in the alternative, in not applying the formula discussed in G.C.M. 9825 (1931), C.B. X-2, p. 146.

We believe that petitioner has convincingly shown that the reasonable value of his personal services was $10,000, and we have found that to be the fact. Although we have concluded that respondent erred in his determination as to the amount of the value of petitioner's personal services, we cannot agree with petitioner that respondent committed error in the manner of the allocation of petitioner's income as between community and separate income. Substantially all of the profits of the enterprise resulted from the skill, judgment, and business acumen of petitioner's father and the use of his credit and capital. In this crucial respect the present proceeding is unlike such cases as Lawrence Oliver, Ashley Manning, both supra, and Estate of Clarence B. Eaton, 10 T. C. 869. They are cases where "the management, activities, and skill of petitioner constituted the principal contribution to the earnings of the business." Lawrence Oliver, supra, 688-689. The allowance of $10,000 which we have found from the record to be reasonable compensation for petitioner's services and which petitioner and his father themselves considered apparently to be reasonable compensation for such service, in our opinion, adequately encompasses as remuneration the totality of petitioner's contribution to the opera-

tions of the business. In view of this finding we would not be warranted to resort to any formula for the purpose of determining what part of petitioner's income from the business represented community income and what part represented a return from capital and therefore separate income. Moreover, there is an absence of proof in petitioner's presentation as to the fair rate of return upon a capital investment in the type of business here before us which is an important element in such a formula, and in the application of the concept of such cases as Lawrence Oliver, supra. Recognizing this defect, petitioner, upon brief, requests that we take judicial notice of what the proper interest rate should be. This we are not permitted to do, even if we were aware of the rate. Cf. Chesapeake and Virginian Coal Co., 13 B.T.A. 323.

Our disposition of these two questions requires a consideration of one other alternative point made by petitioner, namely, that because of the reallocation of income compelled by our result, there should be adjustments upward made in the amount of personal exemption and dependency credits claimed by petitioner on his return.[1] We cannot now disturb the division made between petitioner and his wife, as petitioner's wife is not before us in this proceeding, and no avenue is now open whereby such adjust-

[1]Petitioner and his wife filed separate returns for the taxable year in which they divided as between themselves the personal exemption and credits for dependents allowed by law.

ments can be made. A. L. Lusthaus, 3 T. C. 540, 543; affirmed, 149 Fed. (2d) 232, 327 U. S. 293.

There still remains for consideration four additional issues.

The first involves the deduction of $300 for traveling and entertainment expenses. Aside from the absence of any evidence as to what, if any, amounts were expended for these purposes and aside from the fact that petitioner testified that he may have been reimbursed for some or all of these alleged expenditures, petitioner cannot succeed for the additional reason that if any expenditures were so made, they were partnership expenses; as such they were proper deductions in the partnership return. Hiram C. Wilson, 17 B.T.A. 976. Respondent's determination in this issue is sustained.

Secondly, we are confronted with the question of the proper allowance for accrued California personal income tax of petitioner for Federal income tax purposes. On his return, petitioner claimed the amount of $690.58. In the notice of deficiency, respondent allowed an increased deduction for the California tax on the basis of the estimated amount petitioner would be required to pay. After the state taxing authorities proposed an additional assessment of personal income tax in the amount of $1,484.31, petitioner filed a protest with them, contesting his liability therefor. He has not paid the additional tax, nor has he withdrawn his protest. He continues to contest his liability.

Because of the contest, both as to liability and

amount, petitioner, even though on the accrual basis, is precluded from claiming as a deduction any greater amount than that taken by him on his return. Security Flour Mills Co. v. Commissioner, 321 U. S. 231; Dixie Pine Products Co. v. Commissioner, 320 U. S. 516. Petitioner seeks to insulate himself from the rule of these cases by contending that the issues raised by the state authorities are the same as those presented to us, and that the state authorities have expressed their willingness to rely upon our decision in the determination of the additional state tax assessment. We fail to see that petitioner by this argument has made any meritorious distinction, and respondent must be sustained on this issue.

The third issue is whether the state income taxes are deductible in computing victory tax net income, pursuant to Section 451 of the Code.[2] Petitioner concedes that the question has been decided adversely to him in Anna Harris, 10 T. C. 818, but urges that we overrule that decision. We have carefully considered his argument. We believe, however, that the Harris case was correctly decided and is dispositive of this issue in respondent's favor.

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[2]Sec. 451. Victory Tax Net Income.
(a) Definition.——
* * * * * *
(3) Taxes.—Amounts allowable as a deduction by section 23 (c), to the extent such amounts are paid or incurred in connection with the carrying on of a trade or business, or in connection with property used in the trade or business, or in connection with property held for the production of income.

Lastly, we must decide the problem of the earned income credit allowable to petitioner, which the parties urge may require a consideration of the proper method of computing that credit, under section 25 (a) (3) and (4) of the Code.[3]

Although the parties argue over the procedure to be followed in applying the limitation contained in Section 25 (a) (4) (A), where income is derived

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[3]Sec. 25. Credits of Individual Against Net Income:

(a) Credits for Normal Tax Only.—There shall be allowed for the purpose of the normal tax, but not for the surtax, the following credits against the net income:

* * * * * *

(3) Earned Income Credit.—10 per centum of the amount of the earned net income, but not in excess of 10 per centum of the amount of the net income.

(4) Earned Income Definitions.—For the purpose of this section——

(A) "Earned income" means wages, salaries, professional fees. and other amounts received as a compensation for personal services actually rendered, but does not include any amount not included in gross income, nor that part of the compensation derived by the taxpayer for personal services rendered by him to a corporation which represents a distribution of earnings or profits rather than a reasonable allowance as compensation for the personal services actually rendered. In the case of a taxpayer engaged in a trade or business in which both personal services and capital are material income producing factors, a reasonable allowance as compensation for the personal services actually rendered by the taxpayer, not in excess of 20 per centum of his share of the net profits of such trade or business, shall be considered as earned income.

from a business, in which both personal services and capital are material factors, and the community method of reporting income and deductions is employed by the taxpayer and his spouse, we are not called upon to resolve that problem. Our factual determination that a reasonable allowance as compensation for petitioner's personal services rendered to the partnership was $10,000, and, as such, was community income, gives the parties the additional data necessary to compute the amount of earned income credit to which petitioner is entitled, without necessity of applying the limitation provisions of section 25 (a) (4) (A). This can be computed under Rule 50.

Decision will be entered under Rule 50.

Entered Jan. 6, 1949.

The Tax Court of the United States
Washington

Docket No. 15072

E. R. GOOLD,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

DECISION

Pursuant to the Memorandum Findings of Fact and Opinion entered in the above-entitled proceed-

ings on January 6, 1949, counsel for respondent filed a recomputation of petitioner's tax liability on February 17, 1949. Hearing under Rule 50 was held on March 23, 1949, and on March 24, 1949, counsel for petitioner filed an acquiescence to respondent's computation. Now, therefore, it is

Ordered and Decided: That there is a deficiency in petitioner's income and victory tax for the taxable year ended December 31, 1943, in the amount of $17,793.84.

/s/ J. W. KERN,
Judge.

Entered March 28, 1949.

Served March 28, 1949.

[Title of Tax Court and Cause.]

STIPULATION OF FACTS

It is hereby stipulated and agreed by and between the parties hereto, through their respective attorneys, that the following statements of fact shall be taken to be true in this proceedings and received as evidence herein, subject to the right of either party to offer further and additional evidence not inconsistent with or contrary to the matters herein stipulated:

1. Rolly Goold and Kathryn Goold, his wife, were married on March 7, 1907, and ever since have been and now are husband and wife.

2. As of December 31, 1942, the property described in the document bearing the title "Bill of Sale" a copy of which is attached hereto and marked Exhibit 1-A was owned by Rolly Goold (in this proceeding sometimes referred to as petitioner's father) and Kathryn Goold as community property.

3. As of December 31, 1942, the said Rolly and Kathryn Goold also owned as their community property the following:

Cash on Deposit	$22,481.61
Cash Value of Life Insurance	17,000.00
Stock and Bonds	30,673.09
Real Estate Investments	7,000.00
Personal Residence	6,500.00
	$83,654.70

The last three of the above-mentioned items are listed at their cost of acquisition. As of the above date neither Rolly nor Kathryn Goold owned any property other than that described in this paragraph and in paragraph 2 above.

4. On December 31, 1942, the said Rolly and Kathryn Goold had two children, to wit: Leila Goold McQuilken, a daughter, then 36 years of age, and E. R. Goold, a son (petitioner herein), then 34 years of age.

5. The document referred to herein as Exhibit 1-A was executed by petitioner's father on January 2, 1943. On the same date petitioner executed and delivered to his father a certain document, photostatic copies of the face and back of which are

attached hereto and marked Exhibit 2-B and Exhibit 3-C, respectively. Thereafter, on January 21, 1943, petitioner and his father filed a certificate of co-partnership doing business in the name of R. Goold & Son, in the office of the Clerk of the County of San Joaquin, State of California.

/s/ LAFAYETTE J. SMALLPAGE,
Counsel for Petitioner.

/s/ FRANK C. SCOTT,
Counsel for Petitioner.

/s/ CHARLES OLIPHANT,
Chief Counsel, Bureau of Internal Revenue, Counsel for Respondent.

Of Counsel:

B. H. NEBLETT,
Division Counsel.

T. M. MATHER,

LEONARD A. MARCUSSEN,
Special Attorneys,
Bureau of Internal Revenue.

EXHIBIT 1-A

Bill of Sale

For and in Consideration of the Sum of One Hundred Thousand ($100,000.00) Dollars, payment of which is acknowledged by the execution and delivery of a promissory note dated January 2, 1943, I, the undersigned, do herewith sell and transfer

unto E. R. Goold an undivided one-half interest in and to the following assets, to-wit:

A. Eddy Electric and Mechanical Company. Assets valued at	$ 32,560.83
B. An undivided one-half interest in the R. Goold and A. E. Downer joint venture as shown upon the book of accounts	51,496.04
C. An undivided one-half interest in the R. Goold and F. R. Zinck joint venture as shown upon the book of accounts	10,115.09
D. An undivided one-half interest in the R. Goold and A. R. Liner joint venture as shown upon the book of accounts	2,500.00
E. An undivided one-half interest in the R. Goold and C. L. Wold joint venture as shown upon the book of accounts	25,000.00
F. An undivided one-half interest in the "Marysville" Contract as shown upon the book of accounts.....	40,000.00
Total	$161,671.96

This bill of sale is made for the purpose of enabling the formation of a partnership this day made between the undersigned, R. Goold, and the said E. R. Goold, the assets of which will consist of the foregoing.

Dated: January 2, 1943.

/s/ R. GOOLD.

State of California,
County of San Joaquin—ss.

On this Second day of January, 1943, before me, the undersigned, Notary Public in and for said County and State, personally appeared R. Goold, known to me to be the person described in and whose name is subscribed to the within instrument, and acknowledged to me that he executed the same.

In Witness Whereof, I have hereunto set my hand and official seal the day and year first above written.

[Seal] LAFAYETTE J. SMALLPAGE,
Notary Public in and for said County and State.

EXHIBIT 2-B

$100,000.00 Stockton, California, January 2, 1943.

1. For value received I promise to pay to the order of R. Goold and Kathryne Goold, his wife, or the survivor thereof, the sum of One Hundred Thousand ($100,000.00) Dollars without interest, payable only out of the hereinafter specified source, to-wit:

The payee, R. Goold, and myself have this day formed a partnership known as "R. Goold & Son." I agree that I will pay upon said promissory note a sum equal to twenty-five (25%) percent or more of the annual profits which shall be made to and received by me out of the operation of said business.

2. Should default be made in the payment of any installment of the principal hereof when due, or in any installment of the interest when due, then the whole sum of principal and interest shall become immediately due and payable at the option of the holder of this note. Principal and interest shall be payable in lawful money of the United States, of the present standard value.

3. In event that an action at law be instituted to collect this note, or any portion thereof, or any portion of the interest due hereon, I agree to pay, in addition to the costs and disbursements provided by law, such additional sum as the court may deem reasonable as an allowance to the holder hereof for the fees of its attorney.

/s/ E. R. GOOLD.

EXHIBIT 3-C

12/25/43 Gift	$ 3,000.00
12/31/43 Credit by Error made in Computation of Value of Interest Sold	50,000.00
Changed per Authority of Smallpage, 1/17/47	29,259.00
12/25/1944 By gift	3,000.00
12/25/1945 By gift	18,000.00
1/25/47 Earnings for 1945	7,107.42

[Endorsed]: Filed T.C.U.S. March 29, 1948.

[Title of Tax Court and Cause.]

PETITION FOR REVIEW BY THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

To the Honorable, the Judges of the United States Circuit Court of Appeals for the Ninth Circuit:

I.

Jurisdiction

E. R. Goold, your petitioner on review, hereinafter referred to as the "petitioner," respectfully petitions this honorable Court to review the decision of The Tax Court of the United States entered on the twenty-eighth day of March, 1949, and finding as follows: That there was a deficiency in the petitioner's income and victory taxes for the year ended December 31, 1943, in the amount of $17,793.84 instead of an overpayment of such taxes refundable to the petitioner in the amount of $217.37 as claimed by him in the proceeding before the said Court.

Your petitioner is an individual residing at No. 1225 North Hunter Street in the City of Stockton in the State of California. The respondent on review, hereinafter referred to as the "respondent" is the duly appointed, qualified and acting Commissioner of Internal Revenue of the United States of America, Hon. George J. Schoeneman.

The income tax return in respect of which the aforementioned taxes were paid and in respect of which the aforementioned deficiency and tax liability arose were filed by your petitioner with the

collector of internal revenue for the first collection district of California, located in the City of San Francisco, State of California, which is located within the jurisdiction of the United States Circuit Court of Appeals for the Ninth Circuit.

Jurisdiction in the said Court to review the decision of The Tax Court of the United aforesaid is founded on sections 1141, 1142, and 1143 of the Internal Revenue Code (Pt. 1, 53 U. S. Statutes at L.; Title 26, United States Code).

II.

Nature of Controversy

On January 2, 1943, the petitioner and his father, R. Goold, entered into a partnership under the firm name of R. Goold & Son for the purpose of operating a business which the said father had theretofore conducted as a sole proprietorship, the assets of which business had been owned prior thereto by the petitioner's father and mother as their community property according to the laws of California. The transfer of the one-half interest acquired by the petitioner in his father's business was made by a duly executed and acknowledged bill of sale from the said father to the petitioner in which the interests in the going business theretofore conducted by the father and the said father's interests in certain joint ventures or partnerships in construction contracts were described in general terms and valued at approximate and estimated amounts. In consideration for such transfer the petitioner executed

and delivered to his father a note for $100,000.00 without interest and payable at the rate of "twenty-five (25%) percent or more of the annual profits which shall be made to and received by me out of the operation of the said business."

The petitioner was married and living with his wife, Elizabeth, and four minor children, one of whom was born on June 29, 1943, during all of that year.

In compiling and filing their separate income and victory tax returns, which were prepared on the accrual basis of accounting, for the calendar year 1943, the petitioner and his said wife each returned as income one-half of the petitioner's distributive share of the partnership income of the said partnership, R. Goold & Son, as such share had been returned in the partnership return of income for the same taxable period.

After an examination of the partnership books of R. Goold & Son and of the several joint ventures of which that partnership was a member the agents of the respondent determined (1) that the ordinary distributive income of the partnership business was $1,423.76 less than had been returned, i.e. $119,609.73 instead of $121,033.49; and (2) that all of this income was taxable to the petitioner's father and mother, Mr. & Mrs. R. Goold, and none thereof taxable to the petitioner and his wife on the basis that the partnership of R. Goold & Son was not to be recognized for income tax purposes. After protest of this second finding had been filed with the

internal revenue agent in charge at San Francisco, California, the respondent's position was altered by accepting the partnership as valid but holding that the petitioner's interest therein had been acquired by gift from his father rather than by purchase with the effect that the partnership interest and the income therefrom were to be treated as the petitioner's separate property under the California law rather than as community property. Since the petitioner and his wife had returned the distributive income equally in their separate returns on the basis of its being community property income from a community property interest in the partnership acquired by purchase, the result of the final holding was to transfer approximately $28,000.00 of partnership income to the petioner's return from that of his wife and to subject such transferred income at progressively higher rates of surtax so that the deficiency determined by the respondent on the petitioner's return was over $6,000.00 larger than the refund the respondent was willing to allow on the return of the petitioner's wife.

In the proceeding in The Tax Court of the United States, wherein documentary and oral testimony and a stipulation of facts were introduced with respect to this issue, that Court modified the respondent's determination only to the extent of treating $10,000.00 of the petitioner's share of the distributive income as community property attributable to the petitioner's personal services in lieu of $5,000.00 so treated by the respondent, and found that the re-

mainder of such distributive income was the separate property income of the petitioner as from property acquired by gift. The validity of such a finding by that Court is the principal issue in this petition for review.

A subordinate issue involved in this petition for review relates to the petitioner's deduction of his accrued California income tax on his distributive income from the partnership or R. Goold & Son in computing his net income subject to the victory tax levied for the calendar year 1943 under the provisions of sections 450 to 456, inclusive, of the Internal Revenue Code, as in effect for the calendar year 1943. This is purely legal issue involving the interpretation and construction of provisions of section 451(a)(3), idem, providing for the deduction of taxes "paid or incurred in connection with the carrying on of a trade or business."

III.

Prayer

The said E. R. Goold, petitioner herein, being aggrieved by the findings of fact and conclusions of law contained in the Memorandum Findings of Fact and Opinion entered by The Tax Court of the United States in the said proceedings on January 6, 1949, under the said Court's Docket No. 15072, and its decision entered pursuant thereto on March 28, 1949, prays that this honorable Court may review the said findings of fact and conclusions of law and determine that they have been made and

entered in error according to the following assignments of error.

IV.

Assignments of Error

The petitioner assigns as error the following acts and omissions of The Tax Court of the United States:

1. The finding that the petitioner's share of the partnership business of R. Goold & Son was not acquired by purchase.

2. The finding that the primary reason for the petitioner's execution of the note to his father at the time of the creation of the partnership was to fulfill his father's wish to deal fairly and equitable with both the petitioner and his sister, insofar as their distributive shares in their father's estate was concerned; and that it was intended that the balance remaining due upon the note was to be deducted from the petitioner's share in his father's estate in order to equalize the interests that the petitioner and his sister would receive upon their father's death.

3. The failure of the said Court to apply to the transactions by which the said partnership interest was acquired by the petitioner and to observe the provisions of section 172 of the Civil Code of the State of California.

4. The failure of the said Court to find and hold that the accrued California income tax on his share of the distributive income of the said partnership for the calendar year 1943 was a tax "paid or in-

curred in connection with the carrying on of a trade or business" and deductible according to the provisions of section 451(a)(3), Internal Revenue Code.

/s/ LAFAYETTE J. SMALLPAGE,
Attorney for the Petitioner.

State of California,
County of San Joaquin—ss.

Lafayette J. Smallpage, being first duly sworn, says that he is counsel of record in the above-named cause; that as such counsel he is authorized to verify the foregoing petition for review; that he has read the said petition and is familiar with the statements of fact contained therein; that the statements of fact contained therein are true to the best of his knowledge, information, and belief; that this petition for review is not being filed for delay; and that he believes that the petitioner is justly entitled to the relief sought.

/s/ LAFAYETTE J. SMALLPAGE.

Subscribed and sworn to before me this twentieth day of June 1949.

[Seal] /s/ HAZEL SMIKLE,
Notary Public in and for the
Said State and County.

[Endorsed]: Filed T.C.U.S. June 24, 1949.

The Tax Court of the United States

Docket No. 15072

E. R. GOOLD,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PRAECIPE FOR RECORD

To the Clerk of The Tax Court of the United States:

You are hereby requested to prepare and certify and transmit to the Clerk of the United States Circuit Court of Appeals for the Ninth Circuit, with reference to the petition for review heretofore filed by the petitioner in the above-entitled cause, a transcript of the record in the above-entitled cause, prepared and transmitted as required by law and by the rules of the said Court, and to include in the said transcript of record the following documents or certified copies thereof, to wit:

1. The docket entries of all proceedings before The Tax Court of the United States.

2. Pleadings before The Tax Court of the United States as follows:

(a) Petition for redetermination;

(b) Answer of the respondent;

(c) Amended answer of the respondent filed on March 29, 1948;

(d) The petitioner's reply to the amended answer also filed on March 29, 1948.

3. The findings of fact and opinion of The Tax Court of the United States.

4. The decision of the said Court.

5. The stipulation of facts filed March 29, 1948.

6. The petition for review filed by the petitioner.

7. This praecipe.

You are also requested to transmit to the said Clerk of the said Circuit Court of Appeals the original stenographic transcript of the proceedings of the Division of The Tax Court of the United States in this cause held and had at San Francisco, California, on March 29 and 30, 1948, and the following Exhibits pertinent to the petition for review filed at the hearing of this cause at San Francisco on the days aforesaid, viz: Exhibits 1-A, 2-B, 3-C, and 28.

/s/ LAFAYETTE J. SMALLPAGE,
Counsel for the Petitioner.

[Endorsed]: Filed T.C.U.S. June 24, 1949.

[Title of Tax Court and Cause.]

PROCEEDINGS

EVERETT R. GOOLD

called as a witness for and on behalf of the Petitioner, having been first duly sworn, was examined and testified as follows:

Direct Examination

By Mr. Smallpage:

Q. Mr. Goold, when were you born?

A. September the 24th, 1911.

Q. And who is your father and mother?

A. Mr. R. Goold is my father, and Mrs. Katherine Goold is my mother.

Q. And what other children were there in your family besides yourself?

A. I have a sister, Lela Katherine McQuilkin.

Q. What schooling did you have, Mr. Goold?

A. I attended the Stockton High School and the College of the Pacific, graduated from both.

Q. When did you graduate from the College of the Pacific? A. 1934.

Q. And thereafter what did you do?

A. Well, I worked for—first of all, I was in the service station business for myself for a year or two, and I went to work for the Union Oil Company in 1936, and worked for the Union Oil Company until 1940.

Mr. Marcussen: Would you speak a little louder, Mr. Goold?

(Testimony of Everett R. Goold.)

The Witness: Do you want me to start that over again?

The Court: No.

Mr. Marcussen: No, that is all right.

The Witness: I worked for the Union Oil Company until the year of 1940, and June of 1940 I went in business with my father, went to work for him at that time.

Q. (By Mr. Smallpage): During the year 1940, what did you do for your father?

A. Well, in the first place, when I first went to work for him, I managed the—I was Sales Manager for the appliance department in the electrical business.

Q. What business was your father engaged in at that time? [33*]

A. He was in the electrical and mechanical business, along with the electrical appliances.

Q. Did he do business under the name of Eddy——

A. (Interposing): Eddy Electrical and Mechanical Company.

Q. And that was in Stockton?

A. That was in Stockton.

Q. Now, during the year 1941 what did you do?

A. The year of 1941 I took over the management of—was managing the sales of appliances, and also managing the electrical business, and I believe it was the end of that year that I started to supervise railroad work, which we were doing.

*** Page numbering appearing at top of page of original Reporter's Transcript.**

(Testimony of Everett R. Goold.)

Q. Now, during that year did your father engage in other lines of activity, other than the Eddy Electrical Appliance? A. Yes, sir.

Q. What type of activity?

A. Well, he had several joint ventures going at the time. I believe one was with Thomas C. Buck, in which they were constructing some buildings at the Stockton Air Field, and we were doing railroad work at the Stockton Ordnance Depot. There were various other contracts that I don't recall at the moment.

Q. Now, during the year 1942, what did you do?

A. Well, the year 1942 I practically took over the running of the business at that time. My father —I had [34] supervision, field supervision. All the books were handled by competent accountants, and the office work was handled in our office, but I was doing the field work, the supervision and running of the jobs.

Q. Now, what type of work was under construction by you and your father at that time?

A. Well, we had railroad work and underground utilities, electrical work, and we were joint venturers in—that is, my father at that time was joint venturer with several—he was in with several joint venturers.

Q. Was your father doing war work?

A. Almost exclusively.

Q. When you state you were doing railroad work, do you mean that you built railroads?

A. That is right.

(Testimony of Everett R. Goold.)

Q. Grading and so forth?

A. We installed the railroad trackage in the ordnance depot.

Q. At Stockton? A. At Stockton.

Q. Did you have anything to do with the construction of the Japanese Assembly Camp at Stockton?

A. Yes, at the Japanese Assembly Camp I was in charge of all the electrical work, and worked on that night and day, in fact, completed some 251 buildings in 19 days, I think, at [35] that time.

Q. That was at the request of the government?

A. That is right.

Q. Now, you stated that during that year, 1942, you were about the only one at the business. What was the condition of your father's health?

A. Well, for some time he was ill. He has arthritis, and is subject to attacks of it periodically, and for one period he was down and out of the business for some six weeks, at home and in the hospital. It was practically up to me to run the business at that time.

Q. During the fall of 1942 did you have any conversation with your father and your mother with respect to becoming a partner in the business?

A. Well, that had been the subject of discussion for some time. In fact, when I first went to work for my father it was understood if I was capable that I would be allowed to purchase an interest in the business.

(Testimony of Everett R. Goold.)

Q. Well, what did he say? Withdraw that.

A. Then in the year of '42, why, at the time that he was—I believe he was ill at that time, he suggested this partnership, and I told him that I would be tickled to death to get an interest in the business.

Q. And what did you do then with respect to acquiring an interest in the business? [36]

A. Well, it was referred to our attorneys and our accountants to see how the business could be set up, and how it could be purchased.

Q. And you say it was referred to your counsel, do you mean myself?

A. Mr. Smallpage and Mr. Scott.

Q. Yes. Now, I call your attention to the document which you hold in your hand, Plaintiff's Exhibit 1-A, Petitioner's, rather, entitled, "A Bill of Sale."

Was that document given to you?

A. It was.

Q. And who signed it, to your knowledge?

A. Well, my father signed a copy of it, and I signed a copy of it.

Q. And I call your attention to the item set forth in that Bill of Sale, the first being the Eddy Electric Assets, valued at $32,000, round figures.

From what source were those figures taken?

A. I believe that was the book value of the Eddy Electric Mechanical Company at that time.

Q. Incidentally, what, if anything, was said be-

(Testimony of Everett R. Goold.)

tween you and your father with reference to the value of the assets that would be sold to you in this particular transaction?

A. Well, he said that in order to get this thing organized and going, that we would estimate certain values until [37] we could get a final book analysis. We would set the agreement up, and then it would be adjusted after we found out what the actual book values were.

Q. Now I call your attention to the items under the heading, "F," "E," and "F," respectively, twenty-five thousand and forty thousand dollars.

What did those items constitute or reflect?

A. Well, R. Goold and C. L. Wold, joint venturers, in fact, C. L. Wold, P. Midbust and Anderson and Ringrose, and C. E. Kennedy, and C. E. Kennedy being in fact R. Goold, J. C. McIntosh and C. E. Kennedy, and that was an estimated profit for the year, I believe, or estimated return.

Q. An estimated profit for what year, Mr. Goold?

A. For 1942 or '43. It was anticipated profit for '43, I believe.

Q. In other words, those monies had not been actually acquired by your father at that time?

A. That is right.

Q. Where was that contract being carried out?

A. In Marysville, California.

Q. And was that for the government?

A. For the government, for the United States Engineers.

(Testimony of Everett R. Goold.)

Mr. Smallpage: May I have Exhibit 20-T?

(The Clerk handed the document to Mr. Smallpage.) [38]

Q. (By Mr. Smallpage): I present to you Exhibit 20-T, purporting to be a statement covering the profits upon that particular venture for R. Goold. You will notice that that is entered at the figure of $44,810.04? A. Yes.

Q. Does that reflect the adjusted figure which was the actual amount of the profits received in the partnership for the year 1942 that had been earned, but received in '43?

A. That, I believe, is correct.

Mr. Marcussen: Which figure is that, Counsel? The forty-four thousand dollar figure?

Mr. Smallpage: Yes.

Q. (By Mr. Smallpage): Now, during that year of 1943, what contracts, what work was carried on by the partnership of Goold and Son?

A. R. Goold and Son were in a good—besides the Electrical business were in joint ventures with A. E. Downer, F. R. Zinck, C. E. Kennedy.

Q. I am not so much interested with the names of the people.

A. With the types of work?

Q. I am interested in the type of work that was done.

A. Well, we carried on—we did some work for the Navy, sewer work at the Stockton Pollock Shipyards, and we finished up the Stockton Ordnance

(Testimony of Everett R. Goold.)

Depot Railroad, installed [39] storm sewers at the Stockton Ordnance Depot, built a classification railroad yard for the Western Pacific under the direct supervision of the United States Engineers, and put in storm sewers at the Lathrop Holding and Reconversion Point. Well, there were a number of them. I can't recall the jobs we did in that year. We were quite active.

Q. Well, in dollars and cents, approximately how many hundreds of thousands or millions of dollars of business flowed through your office during that year?

A. Oh, between six and seven million dollars, probably.

Q. What, in your opinion, assuming that you were not a partner in that business, would have been a fair return for your salary for your efforts for the work which you did during that year?

Mr. Marcussen: I object to the question, if your Honor please.

Mr. Smallpage: Submit it.

The Court: I am going to overrule the objection. It is a very interesting point. I don't know whether I am exactly correct or not. The owner of property can testify, without being an expert, as to his opinion as to the value of that property owned. I would assume that the owner of work and services as a rule would be the same, but I am not sure as to that, but I think that is correct. At any rate, I will overrule the objection. [40]

(Testimony of Everett R. Goold.)

A. Well, taking——

The Court (Interposing): Excuse me a minute. I should point out to counsel that the authorities which indicate that the owner of property can testify as to the value of that property without being experts are also to the effect that the probitive value of the testimony is not great.

Mr. Smallpage: That is correct, your Honor, but the difficulty sometimes comes about that it is unable to produce witnesses and testimony relative to the point in question. I understand that.

The Court: Go ahead. I overrule the objection.

Mr. Marcussen: May I state for the record that the basis of Respondent's objection is that it has not been set forth clearly in the record all that Petitioner did in here in the taxable year involved, for which I take it the question is directed to the year 1943, is it, counsel?

Mr. Smallpage: That is correct.

Mr. Marcussen: And on the further ground that he is not competent to testify.

The Court: Proceed.

Q. (By Mr. Smallpage): Give your answer, please.

A. Well, my answer to that is that there were men working—— [41]

Q. (Interposing): No, just a minute. Give your figure. I asked you what you thought to be a reasonable compensation for you on a salary basis?

(Testimony of Everett R. Goold.)

A. I would say $1,000 a month was not too much.

Q. Now, what is the basis for the drawing of that conclusion?

A. Well, from the basis of pay that we paid men under my supervision.

Q. Give the names of several men and their respective salaries and what they did.

A. Well, Mr. A. E. Downer received in the neighborhood of $7500 a year, I believe it was $150 a week, and Mr. C. E. Kennedy, for taking care of the Marysville operation, received $1,000 a month, and inasmuch as I was a part and parcel to that work, and it was going through our books, I think I was entitled to every bit as much as anyone that was on the payroll.

Q. Approximately how many hours a day did you spend in working during that year?

A. Well, that is pretty hard to say, from twelve to fourteen hours, I imagine, it would average.

Q. Now, at the time that this transaction was consummated between your father and yourself, did you execute and deliver to him a note?

2-B, please. [42]

Mr. Marcussen: That is all stipulated, counsel. I suggest you take it and put it in his hands and ask him another question.

Q. (By Mr. Smallpage): Which I present to you, and which is marked 3-C? Did you——

A. (Interposing): Yes.

Q. That is your signature?

(Testimony of Everett R. Goold.)

A. That is right.

Q. Now, I call our attention to the reverse portion thereof, which is marked 3-C. Do you recall at the time that this particular item was marked thereon in my handwriting, "Credit to error made in the computation of value of interest sold, change for authority is Smallpage, 1/17/47, $29,259?"

A. I recall that.

Q. Who was present at the time that that endorsement was made?

A. My father and myself, and I believe you were.

Q. Yes. And was that made solely in order to readjust——

Mr. Marcussen (Interposing): I object to the question on the ground that it is leading.

The Court: Sustained.

Q. (By Mr. Smallpage): What was said at that time between you, your father and myself with reference to the making of that endorsement? [43]

A. That was made to adjust——

Q. (Interposing) What was said, just give the conversation.

The Court: The substance of it.

Mr. Smallpage: The substance of it.

A. Well, the reason for making that entry was to adjust the final returns on the C. O. Wold and Anderson and Ringrose returns for that year.

Q. (By Mr. Smallpage): Well, was anything said with reference to the statement in the Bill of

(Testimony of Everett R. Goold.)

Sale wherein was set forth the items $25,000 and $40,000?

A. Yes, I remember the discussion on it, but it is—I can't remember it at this time.

Q. Well, was there anything said with respect to the item of $44,810.04 as shown in Exhibit 20-T?

A. That was the final adjustment in other words, these were estimates, that the Bill of Sale was drawn up on, was what the note was finally adjusted to.

Q. And did or did not your father request me to make that entry on the note? A. He did.

Q. At the time that that note, Exhibit 2-B, was executed, was there anything said between you and your father with respect to the time—— [44]

Mr. Marcussen (Interposing): I object to the question on the ground that it is leading.

The Court: Sustained. Ask him for the conversation.

Mr. Smallpage: I was just going to, your Honor. I said at the time the note was executed was there anything said with reference to the time of payment. That is what I intended to ask.

A. Definitely that was discussed. At the time I asked him how we would arrive at—before the note was drawn up I asked him how we were going to pay for the business, and he said that they would like a non-interest bearing note, and it would be paid from the net profits, my share of the net profits of the business.

Q. (By Mr. Smallpage): And what did you say?

(Testimony of Everett R. Goold.)

A. I said I couldn't accept anything better than that.

Q. Was there anything said with reference to the withdrawals from the business from time to time of the net profits?

A. Well, they were to be withdrawn when the business warranted it, when it was in such a cash position that it could be withdrawn, after the books were closed and the money was distributed payments were to be made.

Is that the question?

Q. Well I call your attention to this particular paragraph in the note, for the purpose of refreshing your recollection, [45] Paragraph 2:

"Should default be made in the payment"—no, paragraph 1, pardon me.

"The payee, R. Goold and myself have this day formed a partnership known as R. Goold and Son. I agree that I will pay upon said promissory note a sum equal to 25 per cent or more of the annual profit which shall be paid to and received by me out of the operation of said business."

Do you recall any discussion that took place at the time that that particular phrase was——

A. (Interposing): Well, that was to be paid when the distribution of the profits was made.

Q. I call your attention to the fact that on the reversed side of this note, 3-C, that the last item of endorsement is the sum of $7,107.42. I present to you what purports to be a cancelled check for that amount, numbered 914.

(Testimony of Everett R. Goold.)

Did you execute and deliver that check to your father?

A. (Examining document): I did.

Q. And was it paid? A. It was.

Q. Subsequently did you make any further payments on that note which are not shown by endorsements thereon?

A. Yes, I made one other.

Q. I present to you Check No. 924 in the amount of [46] $3,040.04. What is the date of that check?

A. March the 26th, 1947.

Q. And was that delivered by you to your father? A. It was.

Q. And was the check paid? A. Yes.

Mr. Smallpage: We offer these two checks in evidence and ask that they be marked Petitioner's Exhibit next in order.

The Court: Any objection?

Mr. Marcussen: No objection.

The Court: Received in evidence.

The Clerk: Check No. 914 is Exhibit No. 24, and Check No. 924 is Exhibit No. 25.

(The checks referred to were marked and received in evidence as Petitioner's Exhibits Nos. 24 and 25.)

Q. (By Mr. Smallpage): Mr. Goold, was there anything said at any time when you acquired the interest of this business that the same was being given to you by your father and mother as a gift?

A. There was not anything discussed on that.

* * *

ELIZABETH GOOLD

called as a witness for and on behalf of the Respondent, having been first duly sworn, was examined and testified as follows:

Direct Examination

The Clerk: State your name and address.

The Witness: Elizabeth Goold, 1225 North Hunter Street, Stockton, California.

By Mr. Marcussen:

Q. Mrs. Goold, I hand you here a paper which is the original of Exhibits 2-B and 3-C introduced in evidence in this case, and I want to ask you if you have ever seen that before? That is a piece of paper, Exhibit 2-B is this side of it, and Exhibit 3-C is the other side, containing endorsements?

A. No, I never have.

Q. You have never seen that? [48]

A. No.

Q. Now, I want to call your attention to the fact that this purports to be a note signed by your husband in favor of his father in the amount of $100,000, with certain qualifications listed here as to the obligation to pay that amount, and on the back thereof these endorsements, and I want to ask you whether you know anything about any of these endorsements which have been listed here as gifts?

A. No, I don't.

Q. You don't. Did your father-in-law at any time talk to you about these endorsements?

A. No, he didn't.

(Testimony of Elizabeth Goold.)

Q. Did he ever at any time make any gifts to you? A. Well, at Christmastime.

Q. Can you describe generally what they were?

A. Oh, a small check or a war bond, or something.

A. A war bond. How large a war bond?

A. A hundred dollars.

Q. A hundred dollars? A. Yes.

Q. And outside of that he made no gifts to you?

A. Not to me, no.

Q. And did he ever tell you at any time that he had made any other gifts to you than those he had delivered to you? A. No, he has not. [49]

* * *

Cross-Examination

By Mr. Smallpage:

Q. Mrs. Goold, do you recall the time when your husband acquired an interest in your father-in-law's business?

A. Well, I heard him—he told me that he had a chance to, but that is about all. He doesn't discuss his business with me.

Q. Well, was there anything said at that time between you and himself with respect to the terms under which he was going to acquire that business?

Mr. Marcussen: Just a moment. Objection on the ground, please, until it is ascertained who the parties are—a conversation between this witness and who, counsel?

The Court: Her husband.

(Testimony of Elizabeth Goold.)

Mr. Smallpage: Her husband. This is cross-examination of your witness. [50]

Mr. Marcussen: If your Honor please, I will object to the question on the ground it is not within the scope of the direct.

The Court: Oh, I think so. The examination was with regard to the instrument which has been testified is the consideration in the deal.

Q. (By Mr. Smallpage): Do you recall my question, Mrs. Goold?

A. Well, he told me that he would have to sign a note, to get the money to buy into his father's business, to pay for it out of the profits of the business, but other than that, I don't know anything about his business transactions.

Q. How many children have you?

A. Five.

Q. It keeps you pretty busy to keep the house, is that it? A. Yes, it does.

Q. Your husband tends to the business affairs, you take care of the household, is that it?

A. He always has. [51]

* * *

EVERETT R. GOOLD

resumed the witness stand.

Cross-Examination

By Mr. Marcussen:

Q. All right. Now I want to take you back to the first part of your testimony in which you testified you were employed, as I recall, by the Union Oil Company prior to 1940? A. Yes, sir.

(Testimony of Everett R. Goold.)

Q. How long had you been employed by the Union Oil Company? [58]

A. Four years.

Q. Four years. When did you graduate from college, did you say? A. 1934.

Q. What did you do between 1934 and 1936?

A. '36? In 1934 and '36 I had my own service station and business for one year, and then I worked for the firm of Grupe and Weaver for a portion of the year.

Q. What business were they in?

A. Service station business.

Q. And when you had your own service station, what did you make in that year that you were in the station?

A. Well, I imagine, I think that——

Mr. Smallpage: (Interposing.) To which we object. It is immaterial.

The Court: Overruled.

The Witness: Well, I can't tell you what I made. I believe we drew somewhere in the neighborhood of $150 a month out of the business. I had a partner with me in the business.

Q. (By Mr. Marcussen): You each drew $150 a month? A. Approximately, yes.

Q. Do you recall whether the $150 a month was more than you actually made, or approximately correct? [59]

A. No, I think that was about right, about the amount of money we made.

(Testimony of Everett R. Goold.)

Q. Yes. Then how did you come to abandon that enterprise and go with Grupe and Weaver?

A. Well, they offered me a better position, supposedly; I thought it was a better position.

Q. And what was your position with them?

A. I was a manager of the service station, of the super service station.

Q. What did you make in the year you were with them? A. $150 a month.

Q. And then in the four years you were with Union Oil Company, how much did you earn?

A. It varied. I started at $110 a month, when I quit I was making $165 a month and all expenses, a small expense account to take care of an automobile and entertainment.

Q. What were the circumstances attending your abandonment of that employment and in your joining your father?

A. Well, my father purchased his partner's interest in the Eddy Electrical and Mechanical Company in the first part of 1940, and that left an opportunity for me to get into the business with him.

Q. And what did you receive from him when you first started, and also until the time, continuing on until the time you became a partner? [60]

A. I received $40 a week to start with, I believe it was the first year, a little over a year, and then I received $50 a week after that, and $150 a week from the Goold and Downer operation.

(Testimony of Everett R. Goold.)

Q. So that you received a total of $190?

A. $200. Well, I was raised, after a year with my Dad I was raised to $50 a week for the Eddy Electrical and Mechanical Company, and I got $150 from the Goold and Downer operation.

Q. When did the Goold and Downer operation first begin?

A. 1940, I believe, the fall of 1941 or spring of '42.

Q. Yes. And your duties when you first came with your father were superintendent of the electrical sales? A. That is right.

Q. Is that correct? A. Yes, appliance.

Q. What kind of sales was that?

A. Appliance, retail appliance sales. Then I had direction of the electricians at that time.

Q. And what work were the electricians doing?

A. Maintenance and repair, new building work.

Q. Knob and tube work in houses?

A. That is right, cottage work, large electrical wiring installations.

Q. By "large" you mean buildings and industrial—— [61]

A. (Interposing.) Yes, we had some new buildings. I was just trying to recall. I believe we did a job for the State of California at the State Hospital my first year I was there. In dollar volume—I can't give you the dollar volume on it. It is a matter of record, however. Our books would disclose.

(Testimony of Everett R. Goold.)

Q. Approximately how much of a job was that?

A. I wouldn't even venture a guess, I might be too far off.

Q. Well, as compared with knob and tube work, knob and tube work as I understand it, I would like to ask you if I am correct in my understanding, that that is just simply wiring of residential houses and that sort of work?

A. That is right. Cottage work is knob and tube work.

Q. Then work on buildings, industrial buildings and office buildings and hospitals, if you please, is somewhat more complicated and important, isn't it?

A. That is right.

Q. Now, you think you had about one contract during the time that you were manager?

A. Oh, no! There were several contracts during that time, but I can't give you the definite date. And incidentally, I am not an electrician, but I handled the purchase of the material that was needed, and directed the men to the jobs, and saw that they were supplied with the materials for the job. [62]

Q. I see. Well, then you didn't actually direct the installations, is that right? A. No, sir.

Q. Then when the Goold and Downer job was undertaken in 1941,—when in 1941 did you say?

A. Well, I believe it was in the fall of 1941. I am not positive about that.

Q. When that work was undertaken you re-

(Testimony of Everett R. Goold.)

ceived additional salary for services performed in connection with that operation?

A. Not for the first job that they did. It was in '42 that I started to receive a salary from them.

Q. 1942? A. 1942, that is right.

Q. And that was $150 a week?

A. $150 a week, yes.

Q. And what job was that that they were working on at the time?

A. Stockton Ordnance Depot, installation of railroads, and the storm sewers at the Stockton Ordnance Depot, and installation of a sewer system for the Pollock Shipyards.

Mr. Marcussen: Exhibit 4-D, please.

(The Clerk handed the document to Mr. Marcussen.)

Q. (By Mr. Marcussen): I hand you Exhibit 4-D, and ask you to state what work that contract covers? [63]

Mr. Smallpage: To which we except upon the ground the contract itself is the best evidence.

A. Well, that was at the Stockton Motor Depot, at that time called the Fourth Echelon Base Motor Repair Shop.

Q. (By Mr. Marcussen): Yes. Did you do anything in connection with that contract?

A. Nothing.

Q. Now, the work that you performed then in connection with the Downer joint venture, or partnership, on behalf of your father, I presume was

(Testimony of Everett R. Goold.)

performed in pursuance of this contract which is Exhibit 5-E, is that correct? In other words, it was a job——

A. (Interposing.) Well, what job was this? They had, as I recall, they had two jobs.

Q. Well, it was a job that they received after they had executed this document and entered into a general partnership?

A. They have never entered into a general partnership that I know of. There was a joint venture agreement with Downer.

Q. And on this job you testified to, will you state again what were your duties?

Mr. Smallpage: To which we object. Which job do you refer to?

Q. (By Mr. Marcussen): [64] The Downer job that you worked on?

A. Which one? We had numerous.

Q. Any job, all of them?

A. Well, all of them, you say?

Q. For the year 1942? A. '42?

Q. Yes.

A. The Stockton Ordnance Depot Railroad job, and the Pollock Shipyards.

Q. No, I want to know what did you do on those jobs, Mr. Goold?

A. Well, I supervised the installation of railroad at the Stockton Ordnance Depot, and the first job in '41 that went on, storm sewers, were all Downer. He taught me the underground business as far as

(Testimony of Everett R. Goold.)

lines and grades were concerned, and I took over from there.

Q. What do you mean by that, you took over from there?

A. Well, I took over the job and ran it.

Q. Of the underground work?

A. Of the underground work, that is right.

Q. That was in the year 1942? A. '42.

Q. Now, didn't Downer have a superintendent who was doing that work before?

A. He had several of them before I came into the picture. [65]

Q. What happened to them?

A. Well, I think that they were incompetent.

Q. They were dismissed, so far as you know, is that right? A. That is correct.

Q. Now, has your father been a healthy man most of his life prior to 1942, so far as you know?

A. No, he has not.

Q. What has his illness been?

A. He has been subject to attacks of arthritis since he was 31 years old that I know of, but it has gotten progressively worse.

Q. Now, in 1942, I think you say he found it necessary to leave his business for a period of six weeks, part of which he was in the hospital, is that correct? A. That is right.

The Court: I think, gentlemen, we will have to recess at this time.

(Testimony of Everett R. Goold.)

You are not through with this witness, nearly, are you?

Mr. Marcussen: No, I am not. [66]

* * *

Q. How long during the year 1942 did you receive a salary of $150 a week from the Downer operation?

A. I don't know. That is a matter of record on the books.

Q. Well, what is your best estimate, do you have any estimate?

Mr. Smallpage: To which we object on the ground the books are the best evidence.

The Court: The witness already answered that he doesn't have any recollection.

Q. (By Mr. Marcussen): During the year 1943 what compensation did you—or did you receive any salary at all from the partnership or any of the joint ventures in which it was engaged during the year 1943? A. No.

Q. You didn't? A. No.

Q. Did you have a drawing account?

A. Yes.

Q. How much did you draw?

A. To the best of my recollection, it was $150 a week from the Goold and Downer operation, and $50 a week from the R. Goold operation, which was in fact the Eddy Electric and Mechanical Company.

Q. So that you took out a total of $200 a week?

(Testimony of Everett R. Goold.)

A. I believe that is correct.

Q. And did your father have any salary?

A. No.

Q. Did he have a drawing account?

A. Yes.

Q. What was his drawing account?

A. The same.

Q. $50 from Eddy Electric?

A. Yes, and $150 from Goold and Downer.

Q. And at the end of the year were those drawing accounts charged against your share of the profits? A. No.

Q. Were they charged as an expense of the business, do you know? A. No.

Q. In other words, the profit was computed without taking into account this $200 a week which both of you withdrew?

A. I don't understand that question.

Q. All right. I will ask you, do you recall what the profits were for the year 1943?

A. To the best of my knowledge, the profits—well, the income tax reports will give that evidence, and you have that.

Q. But you don't have any recollection of what it is right now? [73] A. Not exactly, no.

Mr. Marcussen: I would like to ask counsel whether he is prepared to stipulate that the drawings were actually charged against the profits and not as an expense, that is, they were credited against the profits?

(Testimony of Everett R. Goold.)

Mr. Scott: That is a fact, yes.

The Court: All right. So stipulated.

Mr. Marcussen: You so stipulate?

Mr. Scott: Yes.

Q. (By Mr. Marcussen): In the year 1943 what were your duties?

A. My duties were supervision of various railroad and underground projects for the United States Engineers, and——

Q. (Interposing.) Which contract? Identify it, if you can, by——

A. (Interposing.) Well, I have a sheet here, a summary sheet made up by our accountant at our request to arrive at our income tax for the year of 1943, and in which he has summarized these jobs.

Now, for the year 1943,—is that the question, which jobs?

Q. That is the year, yes.

A. We had a job at Lathrop which was an unloading ramp. I had nothing to do with that. We had a job for the California Plumbing, which was an underground job, which was [74] rental of equipment. I had nothing to do with that. We had a job for Pollock-Stockton Shipyards. It was a job which I not only had the supervision of, but I had the installation of, in other words, I dug the ditch and laid the pipe and back-filled it, completed the job myself with the aid of two laborers.

Mr. Smallpage: Just give the dollars and cents volume of these respective jobs so the court will

(Testimony of Everett R. Goold.)

know the size and extent of the work which you did.

The Witness: All right.

Mr. Marcussen: Well, now, I am not interested in that just at the present time.

The Court: All right. Go ahead, Mr. Marcussen.

The Witness: We had a job for Shepherd and Green which was an underground job.

Q. (By Mr. Marcussen): Shepherd and Green?

A. Shepherd and Green, in which my only occupation was to order the material and see that it was supplied for the job.

Teichert and Company, a housing project, in which Mr. Downer started the job, and in the center of the job I took over and completed it.

Q. By that what do you mean?

A. He was called away to another job, and I assumed his responsibilities and completed the job to its conclusion. [75]

Q. Well, what duties did you actually perform?

A. In other words, installed—well, I actually told the men what to do, in other words, to put in the catch basins, how to put them in, how to install them, culverts, and installation of the pipe.

Q. What pipes were these?

A. Storm sewers and sanitary sewers.

Q. At a housing project?

A. At a housing project.

Q. How much time did you spend on that, how many months did that job take?

(Testimony of Everett R. Goold.)

A. I believe I was on that job—well, it is a matter of record, my time spent on the job. I would say that I was on the job over a month.

Q. Yes. During that time did you devote—how much of your time during the course of that?

A. 100 percent of my time.

Q. And how about that Shepherd and Green job in which you ordered material, how long did that take?

A. Oh, it was a short job, it was not over a week's duration.

Q. And how about Pollock Shipyard?

A. That was a three-day operation.

Q. And about California plumbing? You didn't do that?

A. I didn't participate in that. [76]

Q. Now, you did this railroad supervision? That is the first item you mentioned?

A. That is correct.

Q. How long a time did that take?

A. That took sixty days.

Q. And how much of your time during that period?

A. 100 percent of my time during that period.

Q. All right. After the Teichert Housing Job which you listed, do you have any others in the year 1943?

A. Well, you have already taken—we had a job at San Pablo.

Q. What was that?

A. Which was a sanitary sewer project.

(Testimony of Everett R. Goold.)

Q. For what?

A. For the San Pablo Sanitary District.

Q. Is that part of a division, of a municipality, do you know, or what?

A. No, it is a district set up solely for sanitary purposes.

Q. And how long a time did that job cover?

A. Well, it is a matter of record how long these jobs took.

Q. Well, I am asking you for your best estimate.

A. I can't recall exactly.

Q. Your best recollection? [77]

A. Well, 90 days.

Q. What was your function on the job? Supervision? A. Correct.

Q. And did that take 100 percent of your time at the time? A. That is right.

Q. Were there any other jobs in 1943 that you worked on?

A. Yes, at the time we were installing the San Pablo Sanitary District underground job we also installed a railroad spur for Moore and Roberts, at Richmond, and I stated that I spent 100 percent of my time on the Sanitary District, but now this refreshes my memory that I did——

Q. (Interposing.) Both of those jobs?

A. Both of those jobs at the time, they were in the same locality.

Q. That was supervision also?

A. That is right.

Q. Now, how many other jobs were there? Just

(Testimony of Everett R. Goold.)

give me the number of other jobs that you haven't mentioned, in 1943.

A. That I had direct supervision over?

Q. That you worked on.

A. That is right. There were a total of seven jobs.

Q. Seven more jobs?

A. No; there was a total of seven jobs.

Q. Oh, a total of seven. You have mentioned some of [78] them, and there are several more?

A. That is right.

Q. In other words, you were doing the same work. Approximately that work was the same as you did in 1942, I take it? A. That is right.

Q. By that I don't mean the same jobs.

A. That is right.

Q. But I mean the same general type of work.

A. That is correct.

Q. Now, in 1942, prior to the time that you got in on this supervisory work for Downer,—by that I mean the Downer job? A. Yes.

Q. Prior to that time you had been receiving $40 a week as general manager of Eddy Electric, is that correct? A. That is correct.

Q. In the appliance department?

A. That is correct.

Q. And you devoted your entire time to it at that time, is that correct? A. That is correct.

Q. Then some time in 1942 you undertook this Downer work, and it continued on into 1943 as you have just described? A. Yes.

(Testimony of Everett R. Goold.)

Q. Who took over your duties in Eddy Electric?

A. We sold out the appliance business, we went out of the appliance business, and then had just maintenance.

Q. When?

A. That is a matter of record, too. I think it was in the year of '42. Our appliances stopped coming in in the year of '41, and as they were sold out we stopped the appliance business.

Q. I see. Why was it that your salary continued notwithstanding that your duties discontinued?

A. My duties did not discontinue, I went from that, as I told you I was directing the electricians along with my sales managing of the appliances.

Q. I see.

A. And I believe at that time we were building a Jap camp, and I had direct supervision of some 65 or 70 electricians.

Q. This was in 1942?

A. Well, now you have got me. It was '41 or '42, I believe it was.

Mr. Smallpage: Just a moment.

May I interrupt?

The Court: Why?

Mr. Smallpage: To fix the date.

Mr. Marcussen: Very well, I will stipulate to that, your Honor.

What was the date, counsel? [80]

Mr. Smallpage: The Japanese camp was created after the war was declared.

(Testimony of Everett R. Goold.)

A. We carried on—for the year of 1944 we were discontinuing, trying to bring to a close the R. Goold and Son and A. E. Downer operation, and we drifted that to a close during the year of 1944, and in 1945 the operation was solely R. Goold and Son, and we continued in the underground and railroad business, and I handled all bidding and supervision of the work on jobs that we did in that year.

Q. Now, during the year 1942 and 1943 and 1944, you have described your duties as being that of supervision of these various jobs in this type of work. In connection with what contract, or shall I say what joint venture, was that work performed?

A. R. Goold and A. E. Downer.

Q. And A. E. Downer.

A. And, as I said before, we were still in the electrical maintenance and repair business, and I handled that.

Q. Yes. Now, was there any work in any of those years [83] that you performed—I hand you Exhibit 1-A in this proceeding and call your attention to the fact that that is what has been introduced as the Bill of Sale here, and I call your attention to Item B appearing on that, and ask you whether the Downer operation is that particular operation that you refer to?

A. What particular operation are you referring to?

Q. Well, you stated that you performed certain

(Testimony of Everett R. Goold.)

services of supervision on certain construction and underground work for Downer?

A. For R. Goold and A. E. Downer.

Q. Yes. Now, is that the particular job?

A. That is not a particular job, that is an account or—well, how shall I stated that?—the net worth of the R. Goold and A. E. Downer venture at the time I purchased a half interest in the business.

Q. I see. Well, that is the same Downer operation, then, for which you performed certain services in the years to which you have just testified, is that correct? A. That is correct.

Q. Now, during any of these years, did you perform any services in connection with the joint venture, the R. Goold and F. R. Zinck joint venture listed in this Exhibit as Item C?

A. In 1942?

Q. Any of these years?

A. Any of these years? [84]

Q. Yes. A. Yes, I did.

Q. What years?

A. Well, there is a question now as to what year the Jap camp work was performed, that was an F. R. Zinck operation, and I worked on that, and I worked on the storm sewer disposal system of F. R. Zinck, the contract was handled in F. R. Zinck's name at the Stockton Ordnance Depot.

Q. Yes. What year was that?

A. Well, those jobs are a matter of record.

Q. You don't recall what year?

(Testimony of Everett R. Goold.)

A. I don't recall what year.

Q. What were your duties on that?

A. In the Jap camp, as I told you, I had direct supervision of all the electricians, and I also aided in acquiring materials and men for that particular job.

Q. Well, now, did Eddy Electric Company have a subcontract from this joint venturer for the installation of an electrical system?

A. That is correct.

Q. And that is the work you did, is it?

A. No. I told you I also aided in getting material for the F. R. Zinck Prime contract in the form of materials and men.

Q. Which one? [85] A. The Jap camp.

Q. The Jap camp? A. That is right.

Q. Did you get any materials for the drainage job? A. Yes.

Q. Now, how much time did you spend on that?

A. I can't state.

Q. Do you have any recollection at all?

A. Well, we were pretty busy during this period, and it is pretty hard to tell you just how much time I allocated to each one of these ventures.

Q. Yes. Well, was it a week, or was it a month?

A. Well, it was more than a week, I mean in a period of time, why, I would say I spent probably five percent of my time.

Q. Over what period of time?

(Testimony of Everett R. Goold.)

A. Well, for the jobs mentioned, on those jobs, whatever the period of those jobs was.

Q. Which jobs?

A. The Jap camp and the storm drainage system.

Q. I see. Now I refer you to Item D on this Bill of Sale which is referred to as the Linner Joint Venture, and ask you if you performed any services in connection with that?

A. There were no services performed by either R. Goold or myself. [86]

Q. Yes. And I will ask you whether or not you performed any services in connection with Items E and F which I understand is the C. L. Wold venture?

A. Only to the extent that we did have a subcontract on the sanitary system in that operation, and I had no direct supervision. It was merely a matter of aiding and abetting in getting men and material for the job.

Q. I see. And you said who had the subcontract on that? A. R. Goold and A. E. Downer.

Q. In other words, that is this first joint venture had a subcontract from this other joint venture?

A. That is correct.

Q. Now, in 1946 what were your duties?

A. We continued in the same line of business, R. Goold and Son, as a partnership, continued in the underground and railroad business and electrical work with the joint ventures of C. E. Kennedy as contractor.

(Testimony of Everett R. Goold.)

Q. In 1947? A. Continued.

Q. Now, during the year 1943, what men did you have working under you?

Mr. Smallpage: To which we except, and ask counsel to specify whether he means the number of men, or an enumeration of the payrolls?

The Court: You mean the names of the men, or how [87] many, or——

Mr. Marcussen: (Interposing.) All right. I will strike the question and start over again.

Q. (By Mr. Marcussen): How many men did you have working under you during the year 1943?

A. It varied from as low as ten men up to three hundred men.

Q. What type of work were they doing?

A. Underground work, and railroad work, and electrical work.

Q. Laboring work?

A. The installation of railroad tracks, and the installation of storm sewers and sanitary sewers and electrical work.

Q. Yes, but these men that you referred to, what work were they doing? Actually, were they laborers?

A. Actually, as the union classified them, some were pipe layers, some were track laborers, some were engineers, and of course, common laborer.

Q. Now, what engineers did you have working for you? A. Operating engineers.

Q. By that you mean of the A.F.L.?

(Testimony of Everett R. Goold.)

A. Equipment operating engineers, that is what they are called.

Q. Yes, excavators? [88]

A. Excavators and shovel operators, motor patrol operators, anything in the heavy equipment line were operated by operating engineers.

Q. You don't refer to civil or mechanical engineers, do you? A. No.

Q. By the way, did you finish your work at the College of the Pacific and take a degree there?

A. I received a Bachelor of Arts Degree.

Q. Bachelor of Arts Degree?

A. That is right.

Q. Now, did Mr. Downer work for you during the year 1943, or under your supervision?

A. We were joint venturers.

Q. Did he work under you?

A. We worked together.

Q. Didn't you testify on direct yesterday that Mr. Downer and another individual, who received substantial salaries, worked under your supervision?

Mr. Smallpage: To which we object on the ground there are two Downers.

Kindly specify which one you mean, counsel.

Mr. Marcussen: The witness is here testifying. I don't have that information.

The Court: Go ahead. Objection overruled. [89]

A. Mr. L. Downer was directly a joint venturer on an equal basis.

(Testimony of Everett R. Goold.)

Q. (By Mr. Marcussen): Equal basis with whom?

A. With R. Goold and Son in the joint venture of R. Goold and Son, and A. E. Downer.

Q. Well, was it your understanding that A. E. Downer—you said that it was L. Downer, is that correct? A. That is correct.

Q. Did he have the major interest, and was he in control of A. E. Downer?

A. He was a joint venturer with R. Goold.

Q. Who was A. E. Downer?

A. A. E. Downer was working for John Pistano when R. Goold met him, and then they worked together as joint venturers in the underground business.

Q. Well, who was he to L. Downer?

A. L. Downer and A. E. Downer are one and the same person.

Q. That is what I am getting at.

Now, I think you stated that R. Goold and Son were in a joint venture with A. E. Downer. Wasn't it the joint venture as is shown here by Exhibit 4-D? Wasn't it between Downer and R. Goold, your father?

A. Previous to 1943, yes, but after 1943 the R. Goold [90] and A. E. Downer operation was, in fact, R. Goold and Son, and A. E. Downer.

Q. Simply by reason of the fact that you came into the business with your father?

A. Correct.

(Testimony of Everett R. Goold.)

Q. Now, who was the other man that you testified to yesterday that was under your supervision, receiving a salary of $7500? No, that was Mr. Downer, wasn't it?

Was that Mr. Downer?

A. Mr. Downer received that amount of money as a drawing account in the joint venture of R. Goold and A. E. Downer.

Q. In other words, that wasn't his salary at all so far as you knew, was it? A. No.

Q. That was his drawing account in the joint venture? A. That is correct.

Q. Now, you said that C. E. Kennedy received $12,000? A. That is correct.

Q. And was that his drawing account?

A. That is correct. No, no; that was his salary.

Q. That was his salary?

A. That was his salary.

Q. And from whom did he receive that salary?

A. From the joint venture of Wold, Midbust and Anderson and Ringrose and C. E. Kennedy. [91]

Q. And did you testify that he was working under your supervision?

A. I do not believe that I testified that he was working under my supervision. If I did, I was incorrect in the statement.

Q. Yes. This railroad work that you referred to, who drew the plans for that?

A. The United States Engineers.

Q. And who set out the stakes?

(Testimony of Everett R. Goold.)

A. The United States Engineers.

Q. On all of these jobs that you worked for for Downer, did the United States Engineers participate and oversee the jobs?

A. I was not working for Downer in the year of 1943. I was working as a joint venturer with Downer in the year of 1943.

Q. I am talking about all these Downer jobs. These were Downer jobs that you did the supervision on, were they not?

A. They were R. Goold and A. E. Downer.

Q. I understand that. I just wanted to be sure we understood each other.

When I refer to the Downer jobs, I mean the work that you and your father and Downer were doing pursuant to a joint venture or partnership agreement, that R. Goold had in [92] the beginning, and later R. Goold and Son had with Mr. Downer. Now, when I refer to the Downer work, that is what I am referring to. A. I see.

Q. Now, all of your work, I think most of your work, I think you testified, was performed on the Downer contracts and under the Downer job, is that correct? A. Most of it.

Q. Yes. Now, on those jobs were there United States Engineers present supervising the laying out of the stakes and surveying? A. Correct.

Q. And all that sort of thing?

A. That is correct.

(Testimony of Everett R. Goold.)

Q. And didn't they direct you in the operation?

A. Absolutely not.

Q. Well, you just simply followed out the stakes and the technical matters that they had laid out, is that correct?

A. We had a set of plans, and the Engineers laid out the stakes, and then, our plans, we installed the railroad trackage and the underground work.

Q. Now, what plans are these? Your plans you referred to?

A. The plans upon which we figure in the jobs which were put out by the United States Engineers.

Q. Yes. You didn't draft these plans, did you?

A. Absolutely not.

Q. And the United States Engineers did?

A. That is correct; that is correct.

Q. Then your job in this thing was supervising the men in the actual performance of the physical work, isn't that correct?

A. Correct; that is correct.

Q. And wasn't Mr. Downer on those jobs too?

A. Mr. Downer was never on a railroad job.

Q. I see. He was, however, on the underground work?

A. He was on the underground work. He broke me into the underground work in '42.

Q. Yes. You worked under his tutelage then during the year '42? A. To start.

Q. Now, what about the year '43?

A. '43 I handled the jobs myself.

(Testimony of Everett R. Goold.)

Q. Was he there at all?

A. At times. Other times he was not present.

Q. Now, what was your total income in the year 1942?

A. It is a matter of record on the income tax report. You have my reports here, I believe.

Mr. Marcussen: I don't think we do.

Counsel, do you have them? [94]

Mr. Scott: The year '43?

Mr. Marcussen: 1942 Income Tax Return.

Mr. Scott: I have a file copy.

Mr. Marcussen: Yes. May I see that?

Mr. Scott: No, I am afraid I spoke without—let me see (Examining documents). No, I don't have it. I am sorry.

Q. (By Mr. Marcussen): Do you have any idea at all what you earned, total earnings were in 1942?

A. No, I don't recall.

Q. Now, in 1942 did you have any income other than from Eddy Electric Company and your income from the Downer operation? A. 1942?

Q. Yes. A. None that I recall.

Q. Yes. And in 1942 what was the extent of your property holdings entirely apart from—well, as of December 31, 1942, what was your net worth?

A. I don't believe I prepared a statement for the year of 1942.

Q. I beg your pardon?

A. Financial statement for the year of 1942.

Q. What property did you own?

A. My home——

(Testimony of Everett R. Goold.)

Mr. Smallpage: (Interposing.) To which we except. [95]

The Court: Objection overruled.

What did you own?

The Witness: A home.

Q. (By Mr. Marcussen): A home?

A. Yes, sir.

Q. Did you own it fully without a mortgage on it?

A. '42? That I would have to recall. I would have to refer to my books to see whether it was paid for at that time.

Q. When did you buy your home?

A. 1940, I believe.

Q. What was the contract price?

A. Near $7,000.

Q. And can you recall now, was it under a mortgage? A. Yes, it was.

Q. How much of a down payment did you make in 1940?

A. Four or five thousand dollars at the time.

Q. You don't recall when the mortgage was paid off, or the balance? A. No, I don't.

Q. What other property did you have at the end of 1942? A. An automobile.

Q. Did you own that completely?

A. Yes.

Q. What kind of an automobile? [96]

A. 1940 Chevrolet Sedan.

Q. What else did you own?

(Testimony of Everett R. Goold.)

A. Home furnishings.

Q. Is that all?

A. Some stock in the Union Oil Company.

Q. How much?

A. It didn't amount to much. I think four shares in the Union Oil Company.

Q. Did you get that as a result of an employee participation plan? A. Correct.

Q. Is that all the property you owned at the end of 1942, so far as you can recall?

A. So far as I can recall.

Q. During the year 1942 do you recall whether or not you sustained any losses of any kind that you might have reported on your income tax return?

A. Well, I believe there was a theft of a radio and some clothes from our home at the time we were moving in.

Q. Did you claim that on your income tax return? A. I don't recall.

Q. What was the total loss?

The Court: How is that material?

Mr. Smallpage: It is immaterial.

Mr. Marcussen: I am attempting to ascertain, if your [97] Honor please, we do have information in the record, and we are prepared to introduce the return for 1943, which contains a computation on 1942, and it shows here, for example, I think a total, the total tax paid in 1942 of some $47.00. I am just putting into the record——

The Court (Interposing): Well, you are just

(Testimony of Everett R. Goold.)

interested in the earnings and net worth of this witness, aren't you?

Mr. Marcussen: Yes. I merely want to establish what was his total income in 1942. He says he has no recollection.

The Court: Well, you have the return, haven't you?

Mr. Marcussen: I have the return of 1943, and on it a computation of the tax, that he showed a tax of $47.00 that he paid for 1942, and this information just lays the foundation to show what the fact was for '42.

The Court: Well, I think that we don't have to go thoroughly into it. I think even that would be enough for your purposes.

Mr. Marcussen: Very well, your Honor. I will discontinue that line of questioning.

Q. (By Mr. Marcussen): Now I hand you this document and ask you to state what that is.

Mr. Smallpage: May I see it, counsel, please?

Mr. Marcussen: His 1943 income tax return.

Mr. Smallpage: I haven't seen it. [98]

A. That is my 1943 income tax return.

Q. (By Mr. Marcussen): Is that your signature here at the foot of the first page?

A. Yes.

Mr. Marcussen: I offer that in evidence, if your Honor please.

The Court: Accepted in evidence.

Mr. Marcussen: As Respondent's——

(Testimony of Everett R. Goold.)

The Clerk: Exhibit X.

(The 1943 Income Tax Return referred to was marked and received in evidence as Respondent's Exhibit No. X.)

Mr. Marcussen: And I ask for leave to submit a copy.

The Court: Leave granted.

Mr. Smallpage: Will you furnish us a copy?

Mr. Marcussen: Don't you have a copy??

Mr. Smallpage: No, we have none.

Mr. Marcussen: You don't have a copy here?

Mr. Smallpage: I haven't got a copy.

Q. (By Mr. Marcussen): Do you have a copy of that return, Mr. Goold, the year 1934 income tax return?

A. I presume that our accountant has it in his hands. I wouldn't know. Our papers have been disturbed so I don't [99] know whether they are in our office, or the Internal Revenue Department's office, or the Attorney's office.

Mr. Marcussen: Very well.

Now, counsel, if you tell me after the trial of this case that you don't have a copy of this return, I think you should make arrangements now to withdraw it and have a copy made. I would like to have a copy made for you, but we don't have facilities for providing copies beforehand. I regret it very much. I will certainly stipulate that you may withdraw it. I will provide you with the copy so that you can have one made from that.

(Testimony of Everett R. Goold.)

Mr. Smallpage: Very well.

Q. (By Mr. Marcussen): Now I want to take you back, Mr. Goold, to conversations that you had with your father in 1942 about your coming into the business.

Now will you please state to the Court the approximate time when those conversations first took place?

A. In 1940 my father bought out his partner, I believe I stated that yesterday. At that time he gave me the opportunity to come into business with him.

Q. What did he say to you?

A. He gave me the opportunity to purchase a half interest in the business if I could prove that I was worth the money, worth the—that I had the value to him as a partner. [100]

Q. You were working at the time with Union Oil Company? A. That is correct.

Q. And on your oath I want you to recollect whether or not he told you that he would let you purchase an interest in it, or whether or not he would eventually give you an interest in that business, on your oath to this Court?

A. Never at any time did he say he would give me an interest in the business.

Q. Never at any time?

A. Not to the best of my recollection.

Q. And at that time in 1940 did you discuss with him on what basis he proposed that you might purchase an interest?

A. I didn't. It didn't enter my mind. I was

(Testimony of Everett R. Goold.)

glad for the opportunity to show whether I could be of enough value to him to become a part owner in the business.

Q. Yes. Now, that was upon the occasion of your entry into the business as an employee in 1940?

A. That is correct.

Q. Now, when was your next conversation with your father about purchasing an interest?

A. Well, it was the year 1942 we discussed it. Well, when he took sick is when we actually began to discuss this.

Q. Can you place that? A. No, I can't.

Q. As to month? [101] A. I can't.

Q. You don't know the month?

A. No, I don't.

Q. You don't know whether it would be in the first half or the last half of 1942?

A. No, I don't, but I imagine that we could produce hospital bills and show was the exact dates were.

Q. Well, I am not interested in exact dates, but you don't know whether it was January or December, do you?

A. No, I don't. That was six years ago, and it is pretty hard to remember things for six years.

Q. How many conversations did you have in 1942, if you remember?

A. Oh, I don't know.

Q. Did you have several? A. Yes.

Q. And on the first of those conversations, what did your father say to you?

(Testimony of Everett R. Goold.)

A. I don't remember.

Q. What did you say to him?

A. I don't remember.

Q. Well, in the next conversation that you had with him, what did your father say to you, and what did you say to him?

A. You want exact words, or generalities?

Q. No, if you know the exact words? [102]

A. I don't know the exact words.

Q. What was the substance?

A. The substance of the conversation was that it was time—he said that I had proved my worth in the business, and that he was discussing it with the attorney and our accountants to see by what method this business could be purchased.

Q. Now, who was the attorney and who was the accountant?

A. Mr. Smallpage and Mr. Scott.

Q. And did he tell you what Mr. Smallpage and Mr. Scott had told him at all about how that might be done?

A. No, I don't believe we discussed that. The next thing I knew I was working, busy, busy with the business, and he had the papers, and he said, "Here is the setup, they have got the papers. If you like the looks of it, fine," if the note was all right, why, it was all right for me to sign.

Q. Now, you don't recall when that was? Well, when you signed, that was on January 3, 1943, is that correct?

(Testimony of Everett R. Goold.)

A. I believe that is correct. That is evidenced on the face of the note, I believe.

Q. And what did you say to your father at the time? A. Well——

Q. Are you referring to some notes now that you have?

A. No, I haven't. I am just making some notes as you talk. Is that all right?

Q. That is quite all right. [103]

A. At the time he told me that he couldn't give me a half interest in the business because it would be unfair to my sister.

Q. Yes.

A. And that is why the promissory note was executed, and it was to be taken from my estate in the event of his death, in the event of his death I would have to pay back, I would have to pay back all the gift portion of that that had been assigned on the back of the note.

Q. He said what?

A. He said that any time—it would not be fair to my sister, he put this down advisedly, it would not be fair to my sister for him to give me a portion of the business, that I must purchase it.

Q. And did you go over with him the figures on the Bill of Sale here?

A. I didn't pay much attention to them, to be honest with you.

Q. You didn't pay any attention to these?

A. I looked at them, but after all, he had been

(Testimony of Everett R. Goold.)

in business a good many years, and it was a sound business deal. I took his advice when he said it was all right.

Q. You signed upon his suggestion?

A. No, I read the thing through and saw, as far as I could see it was fair to me. [104]

Q. I thought you said you didn't give it any consideration?

A. Well I didn't give it any consideration. After all, if a man had been in business for thirty years, and I had been under his tutelage for some two and a half years, then—for two years, I took his advice that it was a good, sound business deal.

Q. You didn't have any conversation with him at all as to the valuations?

A. Well, he said these were taken out of the books, these were the figures out of the books as far as he could ascertain, and he did mention that on the Marysville job there was an anticipated profit.

Q. Yes. And I think you said something yesterday, that you had a conversation with him at the time, that an adjustment would be made in the event that there were any losses on that?

A. That is right.

Q. And what did he say about the prospect that there would be any losses?

A. He didn't think there would be any losses on that job.

Q. He didn't think there would be any?

A. No.

(Testimony of Everett R. Goold.)

Q. Is that all you can recall of your conversation with your father at the time?

A. Well, yes, I believe that is all I can recall at the [105] present time.

Q. He didn't say anything, did he, about any other adjustments that might be made on that figure?

A. No, not that I know of.

Q. Yes. Now, you stated that at that time, on January 2, 1943, that he said that it would be necessary for you to make up any gifts that he would make on his business to your sister, is that correct?

A. No, no, that is not correct.

Q. Well, what did you say about that conversation on January 2?

A. In that conversation he was trying to tie in—he told me that he couldn't give me an interest in the business, he would have to sell it to me, and that it would not be fair to my sister if he was to give it to me, and so he made me sign the promissory note for the interest in the business.

Q. And did he have any conversations with you thereafter about any gifts that he would be making to you?

A. Only after he had made the gift.

Q. Only after he had made the gift?

A. That is right, and he told me at that time that those gifts that he made, in the event of his death his will is set up as such that any gifts that

(Testimony of Everett R. Goold.)

he had made on this note would be adjusted, so that my sister and I would share and share alike. [106]

Q. When was this that your father first had a conversation with Mr. Scott and Mr. Smallpage about this matter?

Mr. Smallpage: To which we object upon the ground it calls for a conclusion of the witness, and a matter not within his direct knowledge.

The Court: Objection overruled.

The Witness: State the question again, please.

(The pending question was read by the Reporter, as follows:

"Question: When was this that your father first had a conversation with Mr. Scott and Mr. Smallpage about this matter?")

A. Well, I don't know.

Q. (By Mr. Marcussen): Was it at or about the time of his illness?

A. I can't recall that.

Q. Well, didn't you state a moment ago that you first had serious conversations with your father about actual proposals for a transfer of a half interest to you after he became ill?

A. That is correct.

Q. And did he say he would talk to Mr. Scott and Mr. Smallpage?

A. He didn't say anything about talking to them.

Q. What did you say a moment ago when you

(Testimony of Everett R. Goold.)

mentioned that [107] conversation he had with Mr. Scott and Mr. Smallpage?

A. When he presented the bill to me he said that Mr. Scott and Mr. Smallpage had drawn up this bill of sale.

Q. Now, then, when you examined this, didn't you think that that was a rather harsh terms for you to undertake, to take a half interest in this business? A. No, I didn't.

Q. You didn't think it was? A. No.

Q. You thought it was perfectly fair?

A. That is right. After all, the accountants and the attorneys had drawn it up, and I thought that it was a fair proposition.

Q. As a matter of fact, it is very fair, isn't it, Mr. Goold? A. I don't know.

Q. Well, do you know whether it is fair or not? Can you get $100,000 any place without paying interest for it? Do you know? A. No.

Q. Do you know any place besides your father where you could get that? A. No.

Q. You don't know of any place where anybody would give you $100,000 and permit you to pay for it at the rate of 25 [108] per cent of the profits you would get on that $100,000? A. No.

Q. You don't know of any place where that could be done, do you? A. No.

Q. Well, you must have come to the conclusion that it was more than fair, didn't you?

A. Why, certainly!

(Testimony of Everett R. Goold.)

Q. Now I hand you Respondent's Exhibit X, which is your 1943 income tax return, and call your attention to the fact that on line 9 here there is an item of $30,258.57. A. Yes, sir.

Q. Which you appear to have reported as your one-half of the total income which you received from this business, and ask you whether you can recall now what the total amount of the income of R. Goold and Son was for 1943?

A. It should have been in the neighborhood of 60,000 for the total income.

Q. That is 60,000 for your share?

A. No.

Q. $30,000 shown on your wife's return, is that correct?

A. Well, I don't know whether that is correct or not. Where is my wife's return?

Q. Well, it is a stipulated fact. [109]

A. Oh!

Q. That you took half of the income and reported half of the income for your wife, so that the total share, your total share covering your wife and yourself as you reported it, would be some $60,000.

A. I see.

Q. And you had a half interest in the business?

A. Correct.

Q. So that the total profits would be $120,000, wouldn't they? A. That is correct.

Q. So the total profits that you yourself made under the community property laws, and which were subject to your control, were $60,000, wasn't it?

(Testimony of Everett R. Goold.)

A. Yes.

Q. Now, what attempt did you make to make any payments on that note out of those profits?

A. None.

Q. You didn't do anything, and can you offer any explanation as to why none was made?

A. Very definitely.

Q. What was the reason?

A. Well, the income return was made up in March of '44, and in September of '43 we were under renegotiation for all War contracts, and under advice of counsel, and for that reason [110] we made no payments on the note.

Q. Did you talk that over with counsel?

A. Yes, sir.

Q. You, yourself, or did your father?

A. Oh, Lord, I don't know.

Q. You don't know? A. No, I don't.

Q. Do you recall having a conversation with your father about whether or not you should make any payments?

A. Well, we surely must have discussed it, or a payment would have been made, and I presume the reason for the payment not being made was that we were under renegotiation, and Mr. Smallpage was handling the renegotiation matters.

Q. On what item were you under renegotiation?

A. All War contracts were under renegotiation.

Q. When was all this renegotiation completed, do you recall?

(Testimony of Everett R. Goold.)

A. It was in the late spring or early summer of '43 or '44. '44, I believe.

Q. Yes. And was any attempt made at that time to make any adjustment on this note for the profits that you had received from the business in the preceding years? A. No, sir.

Q. And why was that?

A. Well, for the reason stated, we were in an unstable [111] situation, we didn't have a definite record back from the renegotiation Board until late in the summer, or the early summer, I don't know the exact dates.

Is that a matter of record? Do you have that? Do we have that on record here?

Q. I am just asking you. After all the renegotiation matter had been settled, Mr. Goold, why was no attempt made to pay the proportion of the profits that you undertook to pay on this note from the profits of the preceding years?

A. Well, I stated that we were under renegotiation, and after that time was cleared, it was a short time after that we were under scrutiny of the Internal Revenue Department, and the thing was continually in a turmoil, and on advice of counsel we did nothing about payments on the note.

Q. Did nothing about payments on the note at all? A. No.

Q. Did counsel tell you that? A. No.

Q. Did you have a conversation with your father about it? A. We discussed that.

(Testimony of Everett R. Goold.)

Q. And it was he that had the dealings with counsel, is that correct?

A. Well, we both had dealings with counsel at various times.

Q. Yes. Did your father have any conversation with you [112] as to about what he proposed to do pending the outcome of the investigation by the Bureau of Internal Revenue?

A. No, we were under advice of counsel.

Q. He just said, so far as you know, "Don't do anything on this thing, the thing is subject to the scrutiny of the Bureau of Internal Revenue," is that correct?

A. Yes, sir, or words to that effect.

Q. Yes. I think you testified yesterday to a figure of six or seven million as the gross value of the business you were doing. Do you recall what year that was for?

A. That was for the total, I believe, that was for the total War operation, wasn't it?

Q. I don't know. It was your testimony, Mr. Goold.

A. Well, I don't recall either. If it is a matter of record we could find it.

Q. Well, what is the fact about it?

A. Well, as far as I know, the year of '43, '42 and '43 and '44, it was in the neighborhood of six and seven million dollars worth of business we did under the R. Goold and Son and joint ventures.

Q. All of the joint ventures are included?

(Testimony of Everett R. Goold.)

A. That is right.

Q. Now, what types of contract were those?

A. War contracts.

Q. Yes. What arrangements were made for compensation to [113] the contractors? Was it on a cost-plus basis?

A. We had no cost-plus work.

Q. No cost-plus work?

A. I believe that there is only one job that we did on a—No, it was not a cost-plus basis either. I believe we had no cost-plus work, to my knowledge. No job that I worked on, at any rate, did we have cost-plus work.

Q. Was it fixed fee?

A. No, most of this was contracted for on the basis of competitive bids.

Q. Yes. And who had these contracts? The other parties that were the joint venturers with your father?

A. R. Goold and Son, and A. E. Downer and other joint venturers.

Q. Well, I am asking you now on the joint ventures that your father and you had with these various other parties? A. Yes.

Q. Whether or not it was your side of the joint venture or the other side of the joint ventures that got the contracts from the government?

A. Well, R. Goold and E. R. Goold figured most of these railroad and underground jobs, in their office, and prepared the bids.

(Testimony of Everett R. Goold.)

Q. Will you answer the question, Mr. Goold? Who got the contracts? [114]

A. R. Goold and A. E. Downer and C. E. Kennedy and R. E. Goold.

Q. Now, isn't it a fact that it was Mr. Downer and Mr. Zinck and the other joint venturers who got the contracts and came to your father with the contracts and said, "Here, will you go in with us on these contracts?" A. No.

Q. What contracts do you know of that your father, or you and your father, actually got?

A. Well, the———

Mr. Smallpage: Just a minute.

I will ask the Court to have counsel explain the word "got."

Do you mean by that, counsel, negotiated with the Government, competitive bids?

Mr. Marcussen: Exactly.

Mr. Smallpage: O. K.

Q. (By Mr. Marcussen): And with the contracting parties?

A. And with the contracting parties? The year of 1943 the Lathrop Unloading ramp, the Pollock-Stockton Shipyards, Shepherd and Green, Oscar H. Vetter, which was a Happy Camp job, which I had nothing to do with; the Capital Construction Company, Caston and Ball, WP Classification yard. We classified that, they were the prime contractors in the WP Classification [115] yard. The crane spur track at the Stockton Ordnance Depot.

(Testimony of Everett R. Goold.)

Q. And who signed that contract?

Mr. Smallpage: To which we object on the ground that the contracts themselves are the best evidence.

The Court: Is the contract in?

Mr. Marcussen: No, it is not, your Honor.

The Court: If the witness knows, he may answer.

A. I don't know.

Q. (By Mr. Marcussen): Did you ever sign a contract with the government, your own name, on behalf of R. Goold and Son, or yourself, or anybody? A. Yes, I have.

Q. You actually signed a contract?

A. Yes, I have.

Q. And entered into a contract, you yourself personally?

A. Not myself personally, but for the joint venturers. With the joint venturers I have signed contracts.

Q. What name did you put down?

A. E. R. Goold.

Q. Now, then, I think you testified that with respect to the Marysville contract, which was part of the Wold joint venture—— A. Yes.

Q. That an adjustment was made to take into account the [116] loss, or not the loss but the reduction in the anticipated profit; is that correct?

The Witness: Would you state that again, please?

(Testimony of Everett R. Goold.)

Mr. Marcussen: Would you read the question, please?

(The pending question was read by the Reporter, as follows:

"Question: That an adjustment was made to take into account the loss, or not the loss but the reduction in the anticipated profit; is that correct?")

A. Yes.

Q. (By Mr. Marcussen): What was the amount of that item, do you recall? A. No, I don't.

Q. I call your attention to the fact that on Exhibit 3-C, which is the back of a note containing endorsements for gifts and payments and other adjustments,—— A. Yes.

Q. That there was first an item of $50,000 entered here as an adjustment under the date of "12/31/43," and it is under the heading of "Credit by error made in computation of value of interest sold," and that the item appears there as $50,000, and that that is stricken out, and that underneath it is placed the item, "$29,259."

How do you explain the $50,000 adjustment?

A. I don't. That was done by counsel. [117]

Q. It was done by counsel. Did you have any conversation with your father about it?

A. I don't recall any.

Q. You don't recall? A. No.

Q. You don't have any idea what that $50,000 is about? Bear in mind, now, Mr. Goold, that this

(Testimony of Everett R. Goold.)

is your note, one hundred thousand dollar note, and there appears on back of it an endorsement of $50,000, and you state to the Court that you don't know what it is about?

Mr. Smallpage: Just a minute! To which we object because the note shows that that $50,000 was scratched out.

Mr. Marcussen: I object to counsel informing the witness, who is answering the question.

Mr. Smallpage: Well, I object to the question because——

The Court: Objection overruled.

Go ahead. Answer the question.

Mr. Smallpage: Let us see the note, please.

The Witness: Now, what is the question?

(The pending question was read by the Reporter, as follows:

"Question: You don't have any idea what that $50,000 is about? Bear in mind, now, Mr. Goold, that this is your note, one hundred thousand dollar note, and there appears on back of it an endorsement of $50,000, and you state to the Court that [118] you don't know what it is about?")

A. No.

Mr. Smallpage: To which we take an exception. It does not bear an endorsement of $50,000.

The Court: The witness answered he doesn't know.

(Testimony of Everett R. Goold.)

Q. (By Mr. Marcussen): Do you know what the twenty-nine thousand dollar figure is for?

A. There was some discussion on that, and I believe that was to correct the anticipated profits in the Marysville operation.

Q. And at the end of 1943 do you know whether the profits were known of the Marysville operation at that time? A. At the end of '43?

Q. Yes. A. I don't know.

* * *

C. E. KENNEDY

called as a witness for and on behalf of the Petitioner, having been first duly sworn, was examined and testified as follows:

Direct Examination

* * *

By Mr. Smallpage:

Q. Now, Mr. Kennedy, did you have occasion to have any conversation with Mr. Rolly Goold, the father, during the year 1943 with respect to the son's acquiring an interest in his business?

Mr. Marcussen: Object to the question, if your Honor please, immaterial in this case what conversation he had with the father.

The Court: Overruled.

A. Well, I discussed with him from, well, even prior to '43 when he contemplated taking his son in partnership.

Q. (By Mr. Smallpage): Just give us the sub-

(Testimony of C. E. Kennedy.)

stance of the conversations which you had with him.

Mr. Marcussen: Same objection, if your Honor please. The father has not even been called to testify as to what those conversations were. The father is the best person to call to state what he said to anybody. It is hearsay in any event, if your Honor please. [124]

The Court: Objection overruled. Answer the question.

The Witness: You want——?

The Court: Just in general, what did he say?

Q. (By Mr. Smallpage): Just in general?

A. In general he told me in '42 that he contemplated taking his son in business with him.

The Court: Any other questions?

The Witness: And when he did take him in business with him, he told me the basis on which he took him in the business, which was that he would take—I remember the exact wording of it—he said he was going to take a one hundred thousand dollar non-interest bearing note for a half interest in the partnership. [125]

* * *

GEORGE ROLLIN GOOLD

called as a witness for and on behalf of the Petitioner, having been first duly sworn, was examined and testified as follows:

Direct Examination

The Clerk: State your name and address.

(Testimony of George Rollin Goold.)

The Witness: George Rollin Goold, 1651 West Flora Street, Stockton, California.

Q. (By Mr. Smallpage): How old are you, Mr. Goold? A. 61.

Q. How many children have you?

A. Two.

Q. What are their names?

A. Lela and Everett.

Q. What is Lela's last name?

A. Lela McQuilken.

Q. What business are you engaged in at the present time? A. Contracting.

Q. What type of contracting?

A. Electrical and heavy construction, railroad work, sewers and water.

Q. Are you at the present time engaged in any type of that business? A. Very actively.

Q. What particular contract?

A. At the present time we have a contract with the East Bay Municipal Utility District for installing about 25,000 feet of pipe in the Orinda District. That job is under progress now, about half completed. [130]

Q. Now, during the year 1940, were you engaged in the business of the Eddy Electric and Mechanical Company? A. 1942? Yes, sir.

Q. Whose business was that?

A. At the start of 1940 it was a partnership, owned by E. W. Suplick and myself.

Q. And when did you buy him out?

(Testimony of George Rollin Goold.)

A. In May, I think it was, in the month of May of 1940, May or June.

Q. And thereafter did you conduct that business as a sole proprietorship? A. Yes, sir.

Q. In 1941, was there a change in the type of business which you conducted?

A. 1941 was the start of the war effort.

Q. Yes. Well, prior to the start of the war effort, what was the type of business that the Eddy Electric and Mechanical Company operated?

A. Practically the same thing. In 1932, ten years prior to that, Eddy Electric and Mechanical Company was engaged in water work, sewer work, construction of railroads on the Port of Stockton. In 1939, Eddy Electric and Mechanical Company as a partnership, constructed a farm labor camp at Twin Falls, Idaho, for a quarter of a million dollars. The contract was carried on under the name of R. Goold, but was in [131] fact a partnership consisting of R. Goold and E. W. Suplick as one partner, and J. C. McIntosh as the other partner.

Q. During the year 1940, did your son, Everett Goold, come to work for you?

A. Immediately on the buying out of this partnership, I offered my son an opportunity to come to work for me in 1940, in either May or June of 1940. I don't remember the exact month.

Q. Did you have any conversation with him at that time with respect to his ultimately acquiring an interest in your business?

(Testimony of George Rollin Goold.)

A. Very definitely.

Q. What did you say to him, and what did he say to you at that time?

A. At that particular time he was an employee of the Union Oil Company, had been with them, I think, for four or five years, was a salesman, had a pretty good job. I brought him over and told him, "Now I have finally got complete possession of this place, and if you want to come over here and go to work for me for a period of time, until I determine what your capabilities are, and how you take hold, ultimately I would like to have you go in as a partner," a conversation which had been previously discussed with his mother and I many times. It was always my desire to have him in partnership when I got the deck cleared, when I could. [132]

Q. Did he continue working with you up to January, 1943, as an employee?

A. He was an employee up to January the 1st, 1943, yes, sir.

Q. Now, prior to January 1943, did you have a conversation with him with respect to his acquiring an interest in your business?

A. Yes, sir.

Q. What did you say to him, and what did he say to you at that time, just the substance?

A. It is hard to recall the exact conversation, but I told him that after three years, the way he

(Testimony of George Rollin Goold.)

had performed, that I was satisfied that he knew what he was doing and could handle the work, and my health was getting in pretty bad shape, I was afflicted with arthritis periodically, which entirely incapacitated me, and I told him that I was prepared now to take him in as a partner. And the question then involved was how was he to come, because he had no money. So I told him I thought in all probability the legal angles of the thing could be worked out, and it could be worked out on a delayed purchase, if he was agreeable to it. We would refer the matter to our attorney and see how it could be handled, how he could eventually acquire an interest in the business.

Q. And subsequently did you present him with any type of documents with reference to this acquisition? [133]

A. Subsequently the matter was gone into with counsel, and documents were prepared and presented to him, yes, sir.

Q. I present to you Exhibit 1-A. Was this document, or one of the documents which you presented to your son at the time that the acquisition of the interest in your business was consummated?

A. Dated January—yes, sir, Oh, yes, sir, you are correct, yes. I know the original consideration was $100,000, and I was looking at the bottom. The original estimated amount was $100,000.

Q. Now I call your attention to the items set forth in that document, which is entitled, "Bill of

(Testimony of George Rollin Goold.)

Sale," particularly Item A, "Eddy Electric and Mechanical Company."

What did those assets consist of?

A. Just as indicated, the assets of Eddy Electric and Mechanical Company, which in 1943 was still a going merchandising concern located at 309 East Weber Avenue, the assets of that concern were the inventory, the receivables, transportation equipment, tools, office equipment.

Q. I call your attention to Item B. What did the Joint Venture between yourself and A. E. Downer—please state to the Court what those assets consisted of?

A. The joint venture of A. E. Downer, R. Goold and A. E. Downer consisted of a joint venture which was set up in 1941, yes, 1941, for the purpose of doing sewer construction work, and [134] railroad work, particularly sewer work because of the fact that A. E. Downer was a sewer man.

Q. And these assets——

A. (Interposing) The assets consisted of—well, the assets in that instance must have consisted of receivables and tools and equipment.

Q. Yes, sir.

Now I come to the next item, C, an undivided half interest in the Goold-Zinck joint venture.

What did that consist of?

A. The undivided half interest in the Zinck venture,—the Zinck venture was started in '42, Zinck was a general contractor, and he was offered

(Testimony of George Rollin Goold.)

a job with the government to construct a Jap concentration camp at Stockton, and it was a matter of—the government expected the job to run $500,000, that was the outside figure that was set on it. It was a job that had to be completed in, I think, we were permitted either two or three weeks to do the job.

Q. How many units, dwelling units?

A. I couldn't answer definitely. If my memory serves me properly, it was some 40-odd buildings, separate buildings for concentration purposes. And Zinck went to C. E. Kennedy and told him that he had beeen offered this job, but he couldn't finance it, it would probably take $100,000 to finance the job. He said to Kennedy, "Can you arrange to finance the job? The [135] government is willing to deliver me the job if it can be financed and bonded."

Kennedy communicated with me, and also communicated with McIntosh to find out if we were interested in entering into a joint venture with Zinck for that purpose. We agreed to enter into a joint venture agreement, under which on this particular piece of work Zinck was to receive 30 per cent, Zinck was to have the complete charge of the operation of the job, we were to furnish the finances, and I was to have complete charge of the office and the disbursements, and the accounting.

Would you like further explanation of that job?

Mr. Smallpage: No, not unless the Court does.

The Court: No.

(Testimony of George Rollin Goold.)

Q. (By Mr. Smallpage): In other words—may I ask a leading question to save time?

The Court: Well, not over objection of counsel.

Mr. Marcussen: I don't know what it is yet, if your Honor please.

Mr. Smallpage: All right, I was just trying to hasten the time.

Q. (By Mr. Smallpage): This item of $10,-115.09, does that represent the book accounts and the value of that interest which you had in the statement at that time? [136]

A. That Item C, I believe now that we find that that was in error, that the——

Mr. Marcussen (Interposing): Object to that, if your Honor please, and move that it be stricken on the ground that it it is not responsive to the question.

Mr. Smallpage: Submit it.

The Court: What was the answer?

(The answer was read by the Reporter, as follows:

"Answer: That Item C, I believe now that we find that that was in error, that the——")

The Court: Objection overruled. Motion denied.

Go ahead. Do you have any other questions?

Q. (By Mr. Smallpage): What was the error?

A. The error was, I think, that the net worth of the whole F. R. Zinck operation at that period —this was on January the 2nd of '43 that Jap

(Testimony of George Rollin Goold.)

camp job was completed, both jobs, the Jap camp job and the supplemental job, we did two jobs for the government, that had been completed, and these figures were gotten from Mr. Gatzert who was then our accountant, and evidently he must have overlooked the fact that what I wanted when I asked for this figure was my interest in the joint venture. Apparently instead of that, he has got the entire interest in the joint venture. In other words, I have sold to Everett Goold something here which doesn't represent the true [137] value, it is in excess of the true value, this portion of the sale.

Q. I present to you this document,—which I ask to be marked next in line for identification.

The Clerk: Exhibit 26 marked for identification only.

(The balance sheet referred to was marked as Petitioner's Exhibit No. 26, for identification.)

Q. (By Mr. Smallpage): I present to you a document marked Petitioner's Exhibit 26 for identification, which purports to be the balance sheet of this particular joint venture as of December 31, '42, as corrected. Is that a true and correct statement of the balance of that account as of that date?

A. From my own knowledge I couldn't say. This is a matter of record. All the F. R. Zinck

(Testimony of George Rollin Goold.)

books are in our organization in perfect condition, and subject to investigation, and——

The Court (Interposing): Well, are those figures taken from the books?

The Witness: These figures here?

The Court: Do they reflect the books, do you know?

The Witness: Must reflect the books, your Honor, yes, sir.

Q. (By Mr. Smallpage): Well, they were taken by your accountant, the CPA, [138] is that right?

A. That is right, yes, they were taken off by Mr.——

Q. Snell? A. Mr. Snell.

Mr. Marcussen: May I ask a question on voir dire here, if your Honor please, to determine whether there should be an objection?

The Court: Go ahead.

Voir Dire Examination

By Mr. Marcussen:

Q. I think you testified this ten thousand dollar figure was with respect to the Jap concentration camp job, is that correct?

A. After the completion of the job, concentration job, a second or a third job was started for the government down at the Stockton Ordnance Base, which was the construction of an underground drainage system.

Q. Yes.

A. And I am not sure in my mind for the

(Testimony of George Rollin Goold.)

moment whether that job was started in '42 or in '43. I think that the job was started in '42 because at that time I was spending quite a bit of time at Marysville.

Q. But I think you said the Jap concentration job was done by January 1, '43, when this agreement with your son, Bill of Sale to your son was drawn up, is that correct? [139]

A. Will you state that again, please?

Q. Didn't you just testify that the job, the concentration camp job, had been done at the time that you executed the Bill of Sale here?

A. I believe I did, yes, I think that is right.

Q. Yes. And that the ten thousand dollar figure, you thought that the accountant erred in presenting you a figure for ten thousand dollars which represented the entire interest in it, instead of just your interest? A. That is correct.

Q. In the Japanese concentration camp?

A. That is correct.

Mr. Marcussen: I object to the Exhibit that has been introduced because it shows it is the drainage job and not the Jap concentration job, no foundation laid, proper foundation laid for the introduction of that exhibit, on the further ground that he cannot authenticate it or verify it.

Mr. Smallpage: Well, the second ground of objection, I take it would be good until we bring in the accountant, your Honor.

The Court: All right, go ahead.

(Testimony of George Rollin Goold.)

Mr. Smallpage: I don't want to jeopardize my record.

Q. (By Mr. Smallpage): Now I call your attention to Item E and F, Items E and F upon that Bill of Sale, which have to do with the Marysville [140] and the Wold joint account, together figured at $65,000.

What were the assets of those two items?

A. The assets of those two items at this particular time were unobtainable. They were unobtainable for the reason that this Wold operation was in the process of completion and closing. That job started off at something over three million dollars, and by the end of the year there had been between five and six million dollars worth of work done, a great deal of which had been done on the nod of the head, why we use that term is that the government said, "Let's proceed with the job and work out a price on it later." And these figures were the nearest to accurate that were obtainable at that time for the reason that definite figures weren't available.

Q. Now, were the books kept in your office?

A. No, sir.

Q. Where were they kept?

A. They were kept on the job at Camp Beale.

Mr. Smallpage: May I have Exhibit 20, please?

(The Clerk handed the document to counsel.)

Q. (By Mr. Smallpage): I call your attention to Exhibit 20-T, which purports to show the net

(Testimony of George Rollin Goold.)

income or profit from this particular partnership, in the amount of $44,810.04.

You are familiar, are you, with that?

A. Those figures, I believe, were prepared by Mr. Snell. [141]

Which figure particularly are you asking about?

Q. I am interested particularly in the figure of $44,810.04.

A. To my knowledge, I can't say that is the correct figure, but the books will reflect exactly what the figure was. My recollection is it was somewhere between forty and forty-five thousand dollars, which was the 1942 settlement. That job extended into 1943, and a complete settlement was not had until '43.

Q. Yes. Well, when that statement came down, Exhibit 20-T, did you then request me, as your counsel, to make an adjustment upon the Bill of Sale for the difference in valuation between $65,000 and the aforesaid sum of $44,810.04, an adjustment upon the note, I meant to say?

A. You were instructed to adjust the note to the books as soon as the information was available as to what the value of the operation was.

Q. I call your attention to Exhibit 3-C, and the item therein set forth which reads as follows:

"Credit by error made in computation of value of interest sold. Change per authority of Small-page to $29,259 in the matter of endorsement."

You recall that?

(Testimony of George Rollin Goold.)

A. I recall that there was an adjustment as to the actual value of the contract after it was ascertained.

Q. Yes, sir. Calling your attention again to that item, [142] Exhibit 2-B, was that note——

A. (Interposing). Is this 2-B?

Q. Yes, sir. The front side is 2-B, and the reverse side is 3-C.

Was that note, that is, the original of which that is a photostatic copy, signed by your son at the time of the acquisition of his interest in your partnership? A. Yes, sir.

Q. Do you recall any conversation with your counsel with respect to the terms of that promissory note?

A. I don't recall the exact wording of the conversations that were had at that time. The intent of the note was that it be so drawn that it could be met out of the profits of the business which would accrue to E. R. Goold as a partner.

Q. Mr. Goold, did you at any time have any conversation with your son, or with your counsel, or with anyone else, the substance of which was that you intended to give——

Mr. Marcussen: (Interposing): Object to the question on the ground that it is leading, if your Honor please. He can testify as to what the conversations were.

The Court: Objection sustained.

Q. (By Mr. Smallpage): At the time that that

(Testimony of George Rollin Goold.)

note was executed, did you have a conversation with your son with respect to the terms of the note? [143] A. Yes.

Q. What did you say to him, and what did he say to you?

A. Well, the conditions that are set forth in the note were discussed and recited, as to how he was going to be able to pay for his interest in the business.

Q. Did you have any conversation with him with respect to a gift of your property?

A. A gift?

Q. Yes. A. No, sir.

Q. Did you at any time ever agree to give him a gift of an interest in the partnership?

A. No, sir.

Q. What is the name of your wife?

A. Katharine J. Goold.

Q. Katharine J. Goold? A. Yes, sir.

Mr. Smallpage: For continuity, your Honor, it is stipulated that this property was community property.

Q. (By Mr. Smallpage): Did your wife at any time give her consent, either orally or written, that you would give away one-half interest in that partnership property as evidenced by the Bill of Sale, Exhibit No. 1-A, to your son?

A. Did she, you say—would you repeat that question, [144] please?

Q. Did your wife at any time, either orally or

(Testimony of George Rollin Goold.)

later on, it is in the process of being rectified, but it was a very expensive venture.

Q. When you say "quite serious," what is the extent of the loss to date?

A. The underwriters——

Q. (Interposing): In dollars and cents what is the sum of the loss to date?

Mr. Marcussen: Object, your Honor. The loss has not been established with respect to the year. This is simply qualifying him, laying a foundation for this exhibit. It has nothing to do with the exhibit.

The Court: Well, I think it is an explanation. I overrule the objection.

Mr. Smallpage: Did you hear the question?

The Witness: Will you repeat the question?

Q. (By Mr. Smallpage): I said in dollars and cents, what is the loss to date?

A. We put up $24,000. [147]

The Court: Just approximately.

Q. (By Mr. Smallpage): Just give me the figures.

A. $24,000 in cash was put up by the——

Q. (Interposing): Well, how much is the loss on Goold and Son, please?

A. At the present time?

Q. Yes.

A. About four thousand, as near as I can recall, for the moment.

Q. All right. Now I call your attention again

(Testimony of George Rollin Goold.)

to this Exhibit 27 for identification, particularly that portion referring to the two Zinck accounts, one being the drainage system and the other for the construction of the Japanese Assembly Center.

A. Yes, sir.

Q. You will note that those two, that the aggregate of those two figures is different from the Item C set forth in the Bill of Sale, Exhibit 1-A. Does this represent the exact amount of your interest in that joint venture, based upon a percentage basis? A. I would believe——

Mr. Marcussen (Interposing): If your Honor please, I object to it on the ground that this document has not been offered in evidence, and I would like to have it offered because [148] I have an objection to it, and he is testifying now as to the substance of it.

The Court: All right. Objection sustained on this line of questioning.

Mr. Smallpage: Very well. That was the purpose of preparing a foundation.

We offer now this document in connection with the testimony of this witness in evidence.

Mr. Marcussen: If your Honor please, Respondent objects on the ground that the material contained in the upper half is already in evidence, and has been stipulated to, and that this witness is not competent to identify this as a correct statement from the books, and it has been brought out here, for example, particularly with respect to one item,

(Testimony of George Rollin Goold.)

that it shows the statement of $3,009.76 as a proprietary interest in the Zinck contract, and it has not been shown as of what date that was. It is stated here as of 1942; at the top is his net worth, and he stated on his previous testimony that the figure was not ascertained until 1943.

The Court: Objection overruled. Admitted in evidence.

The Clerk: Exhibit 27.

(The Financial Statement referred to, heretofore marked as Petitioner's Exhibit No. 27, for identification, was received in evidence as Petitioner's Exhibit No. 27.)

Mr. Smallpage: Cross-examination. [149]

Cross-Examination

By Mr. Marcussen:

Q. I am handing you the same Exhibit 27, Mr. Goold, and ask you to state whether you know that that is a correct statement taken from the books of R. Goold and Son?

A. I do not know whether it is a correct statement. It must have been taken from the books because there would have been no other source, and those books are in my office and available at all times.

Q. Well, but you don't know that it was, do you?

A. I don't know the exactness of any of these figures, because I am not an accountant.

Q. Yes. And calling your attention to the sec-

(Testimony of George Rollin Goold.)

ond item under "other assets," that three thousand dollar figure which we have been discussing, you don't know whether or not the books as of December 31, 1942, shows the value of that Zinck interest at $3,000, do you?

A. I just stated I don't know any of these figures, because I hire accountants to keep these figures, sir.

Q. Yes.

A. That is what we employ accountants for, and what we have Certified Public Accountants for. As to the dollars and cents value of the things, I cannot testify because I am not an accountant.

Q. I hand you Exhibit 1-A here, and call your attention [150] to Item C, that is the Bill of Sale, call your attention to Item C in the amount of $10,000.

Does that cover the same item as the second item under "other assets" under Exhibit 27?

A. I believe I previously testified that this is, in my opinion, an error, and subsequently discovered to be an error. This did not represent my exact interest. It was corrected subsequently. I am assuming that the correction showed these figures, but I didn't work them out myself, sir.

Q. You don't know of your own knowledge, do you, that this ten thousand dollar figure actually is the value that was placed upon the entire operation as distinguished from your interest?

A. I do not know, because I did not keep the

(Testimony of George Rollin Goold.)

books. The books are a matter of record. They have been thoroughly examined by the Internal Revenue Department, and those things are not in my head. They are all a matter of record, sir.

Q. Yes. Now, then, I would like to ask you about the various joint ventures that are listed on the Bill of Sale.

I think you testified to the fact that this value of $32,560.83 for Eddy Electric Company was the value of the entire net worth in the business?

A. That, I believe, is reflected from the books as the complete value of that Eddy Electric and Mechanical Company.

Q. Yes. [151]

A. I believe it is, because I have confidence in the people who prepared it. It was not prepared by me.

Q. Yes. And with respect to Item B, which pertains to the Downer joint venture, who financed that joint venture?

A. R. Goold started the financing of that joint venture, as an individual, in 1941.

Q. And what were the circumstances under which you undertook to finance that?

A. The circumstances under which we undertook to finance it were these: I came in contact with Mr. Downer in 1941. At the time we were interested with Tom Buck in the construction of the airfield at Stockton Air Port, and he was the sewer man running work for a Mr. Pistano who had a

(Testimony of George Rollin Goold.)

subcontract from Buck. He called my attention to the fact that there was a job being offered for bids at the Stockton Ordnance Base, a job which would probably run between fifty and seventy-five thousand dollars, and that he would like to leave his present connection and participate. He was working for a salary, I believe, with Pistano, I believe, at the time, that he would like to leave his present job and join with me in attempting to get the contract for the construction of this sewer work. Downer had no money, I had very good credit, and the job was bid on and taken in the name of R. Goold in 1941, but, as a matter of fact, was a joint venture of R. Goold and A. E. Downer, financed by R. Goold on money borrowed from the First National [152] Bank of Stockton. I can't tell you the exact amount, but it seems to me that they had to have probably ten or fifteen thousand dollars, and I made arrangements with my bankers to get whatever money was necessary to finance the job, should we be the successful bidders.

Q. Yes.

A. We subsequently bid on the job, and I carried the bid to San Francisco, it was the only bid offered by any contractor because it was a tough job, and everybody was afraid of it, we were awarded the job. That was the start of the Goold and Downer venture, if that is the answer to your question, sir.

Q. And you signed the note, did you?

(Testimony of George Rollin Goold.)

A. I signed the note, yes, sir.

Q. Did Mr. Downer sign it?

Mr. Smallpage: To which we object upon the ground that the documents themselves are the best evidence.

The Court: Overruled.

A. I couldn't answer whether Downer signed jointly on that note or not.

Q. (By Mr. Marcussen): At any rate, it is clear——

A. (Interposing): We can produce the note, though, however.

Q. It is clear that Downer couldn't get the money and couldn't finance it?

A. Very clear, yes, sir. [153]

Q. And what particular contract was that that you had in mind?

A. Well, that was—let's see now. That was what we called, on a sewer job. I wish I had that list of the 1942 work.

Q. I hand you Exhibit 4-D, and ask you whether that would refresh your recollection, and whether that is it?

A. Yes, that must be the joint venture agreement between—yes. Now, this must have been after the procuring of the job. That was about the right figure. Before we proceeded with the job, this agreement must have been entered into, and evidently was the original, which must be available.

Q. Yes. A. Was signed by both parties.

(Testimony of George Rollin Goold.)

Q. That is the agreement?

A. That is the agreement. Not the financing, I couldn't testify as to who signed that note.

Q. With respect to this particular contract, Mr. Goold, who had charge of doing the actual physical work?

A. On this particular piece of work?

Q. Yes.

A. Downer himself handled this particular piece of work.

Q. Yes.

A. In conjunction with my son, who was then becoming active in the construction business. He and Downer together were [154] on the job.

Q. Yes. And then you were to receive fifty per cent of the profits for financing it, and also——

A. (Interposing): For financing.

Q. For supplying the services of your son, E. R. Goold?

A. The accounting, I was to receive fifty per cent of the profits for the partnership activity. The job was to be accounted in our office, all moneys were to be handled by me, all checks were to be signed by me, and no purchases made without my permission, previous knowledge.

Q. Well, those figures——

The Court (Interposing): That is in evidence, isn't it, the contract?

Mr. Marcussen: Yes, I think it is, your Honor.

The Court: All right.

(Testimony of George Rollin Goold.)

Q. (By Mr. Marcussen): Now, what was the purpose of those arrangements, to protect you on your note that you had given to the bank?

A. Yes, to be very sure that—as a matter of fact, I can enlarge on that a little more, if I might, counsel, or judge, your Honor.

The Court: No.

Q. (By Mr. Marcussen): Then I hand you Exhibit 5-E, which purports to be an additional agreement entered into between you and Mr. Downer on March 1, 1942. [155]

A. Yes. Well, that, I believe, is correct. I had really forgotten about this having been prepared, but this again, I am sure, was a matter of record, and it was for the reason that the first operation was successful, I was satisfied with the way Downer performed on the job, and we continued to take on other work.

Q. And with respect to that other work that was acquired and done pursuant to this continuation of your original agreement, was the financing and the work performed again in the same manner as it was on this original contract?

A. Only the fact that this led into railroad work, which Downer knew nothing about, but still Downer was taken in as a partner on the railroad work. The railroad work was run entirely by my son.

Q. Yes.

A. Who was familiar with railroad work, and Downer was not.

(Testimony of George Rollin Goold.)

Q. Yes.

A. This R. Goold and A. E. Downer operation, as you have probably considered in the records, run into considerable money. A large percentage of it was railroad work with which Downer was not familiar.

Q. Roughly, what was the other type of work? Was it so-called underground work that Mr. Downer had done? [156] A. Sewers and water.

Q. Yes.

A. And for your information, I had previously done a great deal of that work myself.

Q. Yes. Now, what was the proportion of the work that was railroad work, and what proportion was underground work?

A. I wouldn't want to state that. I just made the statement a moment ago that—I believe I would have to refer to the records to verify this, but I believe that the greater amount of work was railroad work, because of the fact we had one project which ran into figures of one hundred and ninety thousand dollars, if I recall that correctly.

Q. Yes.

A. I think there was 15 or 16 jobs going at that time. Somebody else was accounting for it. It is pretty hard for me to recall the exact figures.

Mr. Smallpage: With counsel and the Court's permission I show you these documents which have a recapitulation of——

The Witness (Interposing): These are work

(Testimony of George Rollin Goold.)

sheets of Gatzert. Goold and Downer at the end of 1943—this summarizes the work, apparently, that was done by Goold and Downer during the year 1943.

This is a railroad job (indicating), this was underground, this is an underground job, this was some underground railroad, and this was railroad, this was underground, this was [157] underground (indicating).

Mr. Marcussen: Well, I don't think there is any point in——

The Witness (Interposing): If you will give me time, I will run those up and tell you what proportion was railroad and what proportion was sewer work, if that is important.

Mr. Smallpage: We will let that go for the moment and take it up with counsel, if counsel wants to do that.

The Witness: Yes.

Q. (By Mr. Marcussen): Now, with respect to Item C on the Bill of Sale, the Zinck operation——

A. (Interposing): We have already covered that, haven't we?

Q. Yes. You financed that also, didn't you?

A. I did not. I assisted in financing.

Q. You and who else, Mr. McIntosh and Mr. Kennedy?

A. Mr. Kennedy did not assist in the financing of that operation. That operation was financed entirely by Mr. McIntosh and myself.

Q. And what did Mr. Kennedy do?

(Testimony of George Rollin Goold.)

A. Mr. Kennedy participated in the management of the job, watched the operation and the proceedings, watched the interest, financial interest of McIntosh and Kennedy, and was given a small percentage of the profit. I think in that particular work [158]—which job are we talking about now?

Q. The Zinck job?

A. The Zinck? Well, that is the Jap camp in '41, if that is what we are dealing with.

Q. About 40 per cent, wasn't it?

A. That was completed. This is January 1st of '43. To continue to answer about that financing, now, I can tell you the proportion of the interest in that first piece of work.

Q. All right. Now, the first piece of work, which was that, the Jap or the drainage job?

A. No, that was the construction of the Jap camp.

Q. The Jap camp. What were the interests in that job?

A. There was the original and the supplemental Jap camp job. I had a 30 per cent interest, McIntosh had 30 per cent, Zinck had 30 per cent, Kennedy had 10 per cent, making a hundred per cent in the two Jap camp operations in 1941.

Q. Yes. And that is included in this Item C?

A. I will have to tell you again that I can't say because I think that that figure is erroneous.

Q. You don't know whether it is included, then, in the $10,000?

(Testimony of George Rollin Goold.)

A. Did you say included or concluded?

Q. Included.

A. It is my belief at the moment that the settlement was made on the two Jap camp jobs, and that the drainage job [159] had been started, but I would have to refer to the records to be sure of that.

Q. Yes. And you received your 30 per cent interest in those Jap camp jobs for financing the work, is that correct? You and Mr McIntosh, is that correct?

A. Financing and accounting. I handled the office matters.

Q. You handled the records again because you were financing it, is that correct?

A. That is correct.

Q. And Mr. Zinck actually performed the physical work?

A. Mr. Zinck was in charge of the operation.

Q. And did Mr. Kennedy provide bond?

A. Did he? No, we provided the bond.

Q. You provided the bond, but he got his 10 per cent, or whatever it was, for looking after Mr. Zinck and supervising it to a certain extent?

A. That is right, yes.

Q. Now, with respect to the drainage job, what about the Zinck drainage job, is that included in this Item C?

A. I can't tell you, I will say again, but I will tell you about the drainage job in great detail, if

(Testimony of George Rollin Goold.)

you wish it. The drainage job came subsequent to the Jap camp jobs, and it was not a very large piece of work, as I recall, some fifty or sixty thousand dollars, and Zinck had done very well in his other [160] undertakings, and done a good job of performing, and on that job, at the start of the drainage job, the operation was performed on a basis that gave Zinck 50 per cent of the operation, McIntosh 20 per cent, and myself 20 per cent, and Kennedy still retained 10 per cent. That was on the drainage job, operation of the Zinck drainage job, and some subsequent small amount of work was done by Zinck on that basis, that was the basis on which the Zinck operation was closed in 1945, I believe, after the work was completed.

Q. Very well, Mr. Goold.

Now I want to hand you Exhibit 7-G here, and ask you whether that covers the drainage job?

A. Twelfth day of June, 1942——

The Reporter: Speak a little louder, please.

Mr. Marcussen: Withdraw it.

The Witness: I was just reading from a document which is here in evidence as to what it was.

Mr. Marcussen: Withdraw the question.

Q. (By Mr. Marcussen): I think this shows that your percentage of the profit on that job was to be 20 per cent, is that correct?

A. I imagine if we run through here we will find some place where that pro rata was set up, yes. This does not show the distribution of the

(Testimony of George Rollin Goold.)

second 50 per cent, this provides that 50 per cent shall be paid to F. R. Zinck and the remaining 50 per cent, [161] and should any loss arise out of this work, said loss shall be borne in proportion to it, and profits on an equal basis, and that the other 50 per cent was to be divided between Kennedy, McIntosh and Goold on a basis to be agreed upon amongst themselves. And I enlarged on that a moment ago and said this agreement, as far as McIntosh, Kennedy and myself were concerned, was on the basis of 20 per cent to McIntosh, 20 per cent to Goold and 10 per cent to Kennedy, 50 per cent to Zinck.

Q. Yes. And that again was for financing, your 20 per cent, is that correct, under that contract?

A. Financing and managing it. Incidentally, for your information, the F. R. Zinck books were kept in my office. They are still in my office. In fact, the accounting was done——

Q. (Interposing): Yes, I am not interested in that right now, unless you think it is necessary to answer the question.

A. I want to give you all the information I can, sir, when I have the opportunity.

Q. When was that job finished?

A. Offhand I can't answer whether it was finished in '42 or '43.

Q. But it was finished in '42 or '43?

A. I couldn't answer without referring to the records.

(Testimony of George Rollin Goold.)

Q. I see. Did you, after the completion of that job, continue in a joint venture with those same parties under an oral understanding with them that you would handle the additional [162] jobs through the succeeding years on the same basis that this job was handled?

A. There was some minor amount of work that was continued to be handled on that basis, until it got to the point where it was so small it was not worth dividing at that time, so we dissolved this joint veenture. I think our records will show a letter of dissolution of the joint venture which was signed by all parties that participated.

Q. Just try to answer my questions, Mr. Goold, if you can.

A. All right, sir, I will try to, but I——

Q. (Interposing): Now, this E and F Item on the Bill of Sale, I call your attention to that, that they total $65,000 there, and ask you what was your share in that joint venture?

A. My personal share, you mean the share of R. Goold as an individual? Was one-ninth of the percentage of the job.

Q. Yes. And is it true that you and Mr. McIntosh and Mr. Kennedy between you had one-third of that entire job?

A. That is correct, yes, sir.

Q. And you received your one-third, collectively for financing that job?

A. Assisting in the financing.

(Testimony of George Rollin Goold.)

Q. Assisting in the financing?

A. Generally, that note at the Bank of America was signed by about 12 people, if I am not mistaken. [163]

Q. When did you first come into that job, do you recall?

A. The joint venture agreement, it must be in evidence, it has been taken from my records, and it is here. I can't tell you offhand.

Q. Well, had it been under way at the time you came in? Just answer this question: Was it under way at the time you, McIntosh and Kennedy came into the picture for additional financing?

A. Oh, no.

Q. You were with it from the beginning?

A. Yes, we were with it from the time the job was started.

Q. Very well. Now, I think you testified, sir, to conversations that you had with your son prior to January 2nd, 1943, when you told him that you were prepared to take him into partnership with you. And before you mentioned that to your son, you testified, I think—strike that, please.

You testified also that you had conversations with your counsel. Now, which came first, Mr. Goold, the conversations that you had with counsel, or those that you had with your son? I am referring now to the time that you identified as shortly before January 2, 1943, when the Bill of Sale was executed.

A. Definitely, I couldn't answer. The whole

(Testimony of George Rollin Goold.)

thing was in process of formation, discussion between my son and I, and the [164] plan to be worked out by which he could acquire an interest in the business, and it was discussed with the attorney.

Q. It had been discussed with the attorney?

A. I say and it was discussed, I presume approximately about the same time. I think it was all cumulative.

Q. Now, when you went to your attorney, what did you say to Mr. Smallpage you wanted to do about this arrangement?

A. It is pretty hard to tell you what I said in exact words at that time.

Q. I don't ask for exact words, but the substance of it?

A. The substance of it was, as the evidence shows, I believe, that I wanted to sell my son a half interest in the business. He had no money.

Q. Now let me ask you this: Do you recall whether or not you told Mr. Smallpage that you wanted to sell him a one-half interest?

A. Do I recall if I told Mr. Smallpage?

Q. Yes. A. Yes, sir.

Q. Or did you ask Mr. Smallpage any questions as to what was the best way of handling this matter?

A. Yes, I asked him the best way to handle it, in view of the fact that the man had no money.

Q. Yes, well, did he tell you, advise you as to

(Testimony of George Rollin Goold.)

whether or not it would be better to handle this by sale or gift? [165]

A. No, sir, "gift" was not discussed.

Q. It was not discussed at all at any time with Mr. Smallpage?

A. There was no intention of gifts.

Q. Then did Mr. Smallpage draft this Exhibit 1-A which is the Bill of Sale, or did you?

A. Mr. Smallpage drafted it.

Q. Did you supply him with the information as to the value of these various items that are listed there?

A. I am inclined to think that I supplied him with some of the information. Some of the information he must have gotten directly from our accounting department.

Q. I see.

A. That is the best of my memory on the matter.

Q. But at any rate you don't know anything about this ten thousand dollar item, do you, this Item C here?

A. I know considerably about the fact that there has been some error there, and I previously so testified.

Q. All right. I think you testified that, or did you tell your son about the doubtful items here, E and F, that there might have to be some adjustment to those accounts for re-negotiation, downward adjustments for re-negotiation?

A. My son's attention was probably called to the

(Testimony of George Rollin Goold.)

fact that these unknown amounts would have to be taken on what we term as goose eggs, in other words, the final figures on the [166] thing would have to be subsequently ascertained.

Q. And was it anticipated at that time that there would be a reduction in those amounts, that there would have to be a reduction?

A. We were unable to tell what the outcome of the job — we didn't know whether the job — we weren't positive the job would be a profit or loss. Apparently the job had progressed far enough so there was a profit, but the exact profit, there was no way to ascertain, that is exactly accurate.

Q. Now I want to call your attention to Exhibit 2-B, which is a copy of the Note, and I call your attention to paragraphs 2 and 3, which I wish you would read. Don't read it out loud, just read it, please, and familiarize yourself with it.

A. (Examining document.) What was the question again, please, now?

Q. Have you read it? A. Yes, sir.

Q. Now, did you say anything to Mr. Smallpage about including that in the note?

A. I wouldn't recall, I couldn't recall if there was discussion on that matter between Mr. Smallpage and myself or not.

Q. Well, it has to do here now with default. Did Mr. Smallpage put that in, or did you put it in?

(Testimony of George Rollin Goold.)

A. I didn't prepare the note. Mr. Smallpage prepared the [167] note.

Q. Mr. Smallpage prepared the note?

A. Yes, sir.

Q. And who was it that determined the method of repayment to be 25 per cent of the actual profits?

A. Mr. Smallpage determined that, I believe, because I don't remember that that was—that was probably arrived at after some discussion, but my memory does not serve me as to exactly how that was worked out.

Q. Now, then I call your attention to Exhibit 3, which is a copy of the reverse side of that note, containing the endorsements, and I call your attention to the original endorsement here of $50,000, which is explained under date of December 31, 1943, as "Credit by error made in computation of value of interest sold," and ask you what you know about that fifty thousand dollar figure?

A. I don't know anything about the fifty thousand dollar figure. That endorsement was all in the hands of our attorney.

Q. Yes, and it is stipulated that that is in his handwriting too in this case.

A. I believe that that is right. I will say this, that it isn't in my handwriting, it isn't in my son's.

Q. Yes. Now, you don't have any explanation to offer for that $50,000 appearing there?

A. None whatsoever, no. [168]

Q. This was a piece of property of yours, a one

(Testimony of George Rollin Goold.)

hundred thousand dollar note from your son, and there is an endorsement showing a payment of $50,000 on it, and you know nothing about it, is that correct?

Mr. Smallpage: To which we object upon the ground that is not a proper statement.

Mr. Marcussen: I am asking him if that is correct.

Mr. Smallpage: Well, the note speaks for itself.

The Court: Objection overruled.

The Witness: What was the question?

(The pending question was read by the Reporter, as follows:

"Question: This was a piece of property of yours, a one hundred thousand dollar note from your son, and there is an endorsement showing a payment of $50,000 on it, and you know nothing about it, is that correct?")

Mr. Smallpage: To which we object. It is not a statement of fact, if your Honor please.

The Court: Objection overruled.

A. I knew that there was some adjustment made on this account, and I knew that it was anticipated there would have to be an adjustment because of the fact that the face of the agreement carries a lot of goose egg computations there, that matter, when the books were finally gotten into shape so that it could be—— [169]

Q. (By Mr. Marcussen) (Interposing): By goose eggs do you mean round figures?

(Testimony of George Rollin Goold.)

A. Yes. Excuse my slang on that.

Q. Well, you don't know how the $50,000 was arrived at? A. No, I don't know.

Q. Did you have any conversation with Mr. Smallpage about that?

A. I don't recall that, no, sir.

Q. You don't? A. No, sir.

Q. And that is crossed off, I call your attention to that fact. A. I noticed it.

Q. Then underneath it says, "Changed per authority of Smallpage, 1/17/47," 1947, and it is reduced to $29,259.

Now, what do you know about that item?

A. Well, that item is an adjustment of the exact value of the books at the time, I take it that that is the exact value, the computation of the exact value of this note after adjustment.

Q. For these items here? A. Yes.

Q. And I hand you Exhibit 20-T, which contains the detail on it, and I think you testified on your direct examination that the correct amount of that figure turned out to be [170] after renegotiation, $44,810.04?

A. I believe that this is correct. This is taken from our records.

Q. Yes, and the twenty-nine thousand dollar figure, I think you testified, was to adjust for the difference between this $44,810.04 and the total of $65,000 there, is that correct?

(Testimony of George Rollin Goold.)

A. That is correct, it is to correct a hundred thousand dollar valuation.

Q. Yes. I want to call your attention to the fact that the difference between that $65,000 item and the $44,810.04 is actually $20,189.96.

A. Yes, sir.

Q. Now, how do you account for that discrepancy? A. I can't account for it, sir.

Q. You can't account for it?

A. No, sir, I know nothing about that.

Q. Now, in making this sale to your son, did you have any conversations with your attorney as to whether or not this note should bear interest? Who determined that?

A. There must have been conversations or it wouldn't have been written up that way. I can't recall the conversations.

Q. You can't recall telling your attorney about it?

A. I can't recall the conversations, no, sir.

Q. But you were satisfied to take his note without interest on it? [171]

A. That is right, yes, sir.

Q. And now, then I call your attention to the first item on the endorsement of Exhibit 3 here, which is under date of December 25, 1943, under the designation, "gift," and it is $3,000.

Did you talk to your attorney about that?

A. Yes, sir.

Q. And also about this item of 12/25/1944 and

(Testimony of George Rollin Goold.)

12/25/1945, the first of which is in the amount of $3,000 and the second $7,000 by gift. Did you talk to your attorney about those items?

A. Yes, sir.

Q. And I call your attention to the fact that the profits—this note was to be repaid out of profits from time to time? A. That is correct.

Q. And I call your attention to the fact that the only endorsement on here on this note is under date of January 25, 1947, and it refers to earnings for 1945, and the endorsement is in the amount of $7,107.42. A. Yes, sir.

Q. I ask you why weren't there other endorsements for the profits that were made throughout these years?

A. I would like to explain that. In '43, they were forgiveness years, if I am not mistaken, between '42 and '43 there was a choice between '42 and '43 on the matter of forgiveness, the method of payment of taxes had been entirely [172] changed. The earnings for 1945—you are asking about why this endorsement is on here?

Q. Why is it only in that amount and why weren't there endorsements for the other earnings of the business, the son's share?

A. Because the condition of the business was so confused during that time that we didn't know exactly what his earnings were. The Internal Revenue Department had attacked the validity of the partnership, they had attacked the sale, and Mr. Smallpage and Mr. Scott were in continuous con-

(Testimony of George Rollin Goold.)

sultation with the government relative to this matter, and on the advice of Mr. Smallpage, he advised that we should do nothing with the note until such time as those matters were straightened out.

Q. Yes. And has any other payment ever been made since that time?

A. There is a subsequent payment for the year of '46, as I recall.

Q. I think in the amount of $3,040?

A. Some two or three months later, there was a payment made for '46 on the advice of counsel.

Q. Now, what years did that cover, what profits were those?

A. Well, I would have to see the answer. It was for '46, I presume.

Q. Now, I think the evidence that has been introduced [173] here will show that your son even for the year 1943 had a share in the profits of $60,000, and the evidence will also show substantial earnings for the succeeding years, '44, '45, '46 and '47, and I ask you whether you have any explanation as to why, since the conclusion now of all these income tax matters relative to the recognition of the partnership, why wasn't his share of the earnings endorsed on that, and why wasn't his share devoted to paying his obligation on this note?

A. Frankly, I didn't think there was a conclusion of the Internal Revenue matter. I thought that is what brought us here at the present time.

Q. The partnership is recognized, you understand that, don't you?

(Testimony of George Rollin Goold.)

A. No, I have no assurance that the partnership is recognized. I understood that the partnership was being attacked in this proceedings.

Q. Well, if you were told that the partnership is not being attacked in these proceedings, and that your attorney knows that, and that he knew it was not being attacked from the beginning, way back in 1945, now, do you have any other explanation that you want to make as to why your son's share of the earnings were not applied in the payment of this note in accordance with the terms of the note?

A. Just a matter of confusion.

Mr. Smallpage: To which we object upon the ground [174] that counsel has made a misstatement of fact, your Honor.

The Court: Objection overruled.

Mr. Smallpage: Well, may we——

The Court (Interposing): The objection is overruled. The witness may answer.

Mr. Marcussen: Can you answer?

The Witness: Will you repeat the question, please?

(The pending question was read by the Reporter, as follows:

"Question: Well, if you were told that the partnership is not being attacked in these proceedings, and that your attorney knows that, and that he knew it was not being attacked from the beginning, way back in 1945, now, do you have any other explanation that you want

(Testimony of George Rollin Goold.)

to make as to why your son's share of the earnings were not applied in the payment of this note in accordance with the terms of the note?")

Mr. Smallpage: I respectfully suggest, your Honor, that that is assuming a fact not in evidence. The partnership was continuously under attack until August the 8th, 1946, when it was recognized.

The Court: Objection overruled. He is asked to assume certain facts.

If you assume the facts stated by counsel for the Respondent, what is your answer? Have you got any other reason why your son didn't make any payments on these notes? [175]

The Witness: No.

The Court: This note? That is the only reason you have, that there was trouble with the Bureau of Internal Revenue, is that right?

The Witness: That is correct, yes, sir.

Q. (By Mr. Marcussen): Now, was it your purpose in making this purported sale to your son to have him pay merely for one-half the value of these assets transferred?

A. That is the terms of the note, I believe, sir, yes.

Q. Well, I call your attention to the fact that in the Bill of Sale——

A. (Interposing.) The terms are in the Bill of Sale.

(Testimony of George Rollin Goold.)

Q. ——the total of the assets transferred is $161,000 some odd, and that he signs a note for $100,000.

A. Well, I have no explanation on that as to why that amount was set up at $100,000, except for the fact these items down here were unknown at that particular time.

Q. They turned out actually to be less, but even on the figures that you have got on the Exhibit 1, the total of the assets in which you are conveying to him one-half interest totaled $161,000, and you have him sign a note for $100,000. Do you have any explanation to offer for that?

A. The note was prepared by counsel. Just what the particular reasons for it were I couldn't tell you. [176]

Q. Did counsel determine the amount of the note?

A. No, counsel determined the amount of the note, the amount of the note——

Q. (Interposing.) Was $100,000. Now, who decided upon that $100,000?

A. I believe that it was counsel who decided to set the note up at $100,000, and make subsequent adjustments if it became necessary as to what the figures should be.

Q. And now, at the time that you received this note and had your son sign it, did you ever expect to receive any payments from him on it?

A. I certainly did.

Q. Full payment? A. Yes, sir.

(Testimony of George Rollin Goold.)

Q. After adjustments were made for any errors?

A. That is right.

Q. And valuation of certain items included on the Bill of Sale?

A. At the time this note was prepared it was my expectation that he would pay the note in accordance with the terms of the note.

Q. Yet you never insisted that any of the profits be devoted to it, even after the income matter was cleared up?

Mr. Smallpage: Objected to, stating a fact not in evidence. The income tax matter was not straightened up. [177]

The Court: That part of the question will go out. The answer is that he never insisted on his son paying any part of the note.

Q. (By Mr. Marcussen): Now, do you ever recall talking to Mr. McCubbin about this case, who was an Internal Revenue Agent who came out to see you?

A. Some slight conversation. Mr. McCubbin spent considerable time in our office.

Q. Do you ever recall that he questioned you about the amount of the costs of the interest included on the Bill of Sale, and their fair market value, and do you ever recall telling him that you never expected to be paid anything on that note?

Mr. Smallpage: One minute. To which we object on the ground the proper foundation has not been laid, the time, place and people present, and the conversation at least substantially given.

(Testimony of George Rollin Goold.)

The Court: Objection overruled.

Do you recall that?

Q. (By Mr. Marcussen): On your oath?

The Court: Do you recall saying that?

A. The answer is "no," I don't recall.

The Court: The answer is "no."

Q. (By Mr. Marcussen): [178] Do you recall stating to Mr. McCubbin that this matter had been in the hands of your attorney, and that he had prepared the matter, and that you knew nothing about income taxes, and that, in answer to his questions, you didn't want to fall into any trap?

A. I don't recall any such conversation about falling into any trap, no, sir.

Q. You don't recall? A. No, sir.

Mr. Marcussen: That is all, your Honor.

Mr. Smallpage: Will you stipulate that that is a true and correct copy of the original letter from the Conferee's office respecting this matter, from the Internal Revenue Department?

What time does your train leave, your Honor?

The Court: That is all right, we will go right ahead.

Mr. Smallpage: I have only taken 25 minutes.

The Court: That is all right, don't be alarmed.

Mr. Marcussen: (Examining document.) No objection.

Mr. Smallpage: We offer this in evidence.

The Court: It will be admitted in evidence.

Mr. Smallpage: And ask it be marked next in order. For continuity, I want to say, your Honor,

(Testimony of George Rollin Goold.)

it is a letter of compromise from the Department with respect to recognizing the partnership, providing that we do certain things, and the date [179] of it is August, 1946.

The Clerk: Exhibit 28.

(The letter referred to was marked and received in evidence as Petitioner's Exhibit No. 28.)

PETITIONER'S EXHIBIT No. 28

Treasury Department
Internal Revenue Service
San Francisco 5, Calif.
August 20, 1946

Office of
Internal Revenue Agent in Charge
San Francisco Division
74 New Montgomery Street

In Replying Refer to IRA:Conf-ALW

Mr. LaFayette J. Smallpage
Room 511, Savings and Loan Bank Building
Stockton, California

In re: R. Goold and Son
R. Goold
E. R. Goold
Stockton, California

Year: 1943

Dear Mr. Smallpage:

In further reference to the protests filed by you with respect to the above-named taxpayers for the

(Testimony of George Rollin Goold.)

year 1943, the following adjustments are suggested as a basis for settlement. In case you are willing to close the cases on this basis, the result will be subject to approval by the reviewing authorities in this office and in the Bureau.

(a) To recognize the partnership between R. Goold and E. R. Goold.

(b) To consider the transfer of an undivided one-half interest in the partnership assets as a gift to the son instead of a sale as claimed; gift tax to be adjusted and determined later.

(c) To consider that the son's interest in the partnership is his separate property, and that his distributive share of the partnership profits is taxable in full to him except one-half of a reasonable salary for his services of $5,000.00, or $2,500.00, which amount will be taxed to his wife, as her one-half share of the community income.

(d) Since the deduction of $2,211.00 claimed for Mr. R. Goold's expenses in connection with the Marysville job was incurred over a period of 67 weeks running from March 23, 1942 to September 1943, and since there are no records to verify such expenditures, a deduction will be allowed of $500.00 to cover cost of meals and lodging at Marysville for estimated 35 trips made in 1943 and for automobile expense. Mr. Goold used an automobile which belonged to the electrical appliance business and it is assumed that most of the expenses of this car were

(Testimony of George Rollin Goold.)

included in automobile expenses claimed and allowed to that business.

(e) If the above-stated adjustments are acceptable to the taxpayers, the personal exemption and credit for dependents will be allowed in full to E. R. Goold since this adjustment will be to the mutual tax advantage of E. R. Goold and his wife.

Please advise this office at the earliest available time as to whether the settlement as set forth above is acceptable to the taxpayers in question. Another hearing in this office for further discussion of the issues and the basis of settlement will be granted upon written request.

Very truly yours,
/s/ A. L. WILKINSON,
Conferee Revenue Agent.

AL/W :eh

cc to Mr. R. Goold and
Mr. E. R. Goold

Mr. Smallpage: It will be considered as read in evidence?

The Court: That is right.

Mr. Smallpage: That is, the significant portion.

The Court: I don't have to get away from here until three o'clock, I just want counsel to know.

Mr. Smallpage: I am hurrying my examination along a little, but I took account of my time. I have exactly 25 minutes.

(Testimony of George Rollin Goold.)

I ask that this document be marked Petitioner's Exhibit for identification next in number.

The Clerk: Marked for identification only Exhibit 29.

(The document referred to was marked as Petitioner's Exhibit No. 29, for identification.)

Redirect Examination

By Mr. Smallpage:

Q. I present this document to you, which has been taken out of my file, respecting this matter, which is entitled, "Assets conveyed to Everett R. Goold, January 1, 1943, which becomes the assets of partnership R. Goold and Son."

I ask you if that document was given—— [180]

Mr. Marcussen (Interposing): Object to the question on the grounds it is leading, and ask counsel, if your Honor please, to ask the witness what that document is.

The Court: All right, what is it, Mr. Witness?

Mr. Smallpage: Wait a minute, may I——

The Court: All right, reform your question.

Mr. Smallpage: I just gave the title.

Q. (By Mr. Smallpage): Was that document delivered by you to me?

Mr. Marcussen: Object to that on the ground it is a leading question.

The Court: Objection sustained.

Mr. Smallpage: A leading question to ask him if he gave it to me?

The Court: That is right.

(Testimony of George Rollin Goold.)

Mr. Smallpage: Do we take exceptions?

The Court: Exception noted. The witness can be asked to describe that letter, or that document, what it is, and what he did with it, if he knows. This is direct examination, redirect examination.

Q. (By Mr. Smallpage): Well, is that document in your handwriting?

A. The document is in my handwriting, yes, sir.

Q. All right. What did you do with it?

A. This was a document that was turned over to you at the [181] time that we were preparing to sell this partnership interest, half of it, to sell this partnership interest on January the 1st, 1943, and in my writing down here I have subscribed "the above is the interest of R. Goold on the above day, and are the assets of the partnership. All of the above is community property of R. Goold and Katharine Goold, his wife."

Q. I call your particular attention to the words, "estimated."

A. Opposite two of the accounts here I have written the words "estimated" because of the fact we weren't able to determine the value at that time.

Mr. Smallpage: We ask that this be admitted in evidence.

The Witness: The books didn't disclose that.

The Court: Admitted.

The Clerk: Exhibit 29.

(The document referred to, heretofore

(Testimony of George Rollin Goold.)

marked as Petitioner's Exhibit No. 29 for identification, was received in evidence as Petitioner's Exhibit No. 29.)

Q. (By Mr. Smallpage): Now, during 1943, Mr. Goold, in the fall of 1943, did you receive a request from the War Department, Price Adjustment Board, for renegotiation, dated September 22, 1943, demanding that you submit for renegotiation all contracts which you, either as an individual, or as a partnership of yourself [182] and your son, had with the government during the years 1941, '42 and '43?

A. We were called on by the government to submit renegotiations during the year '43. The exact date I couldn't recall. Some time, I believe, about the middle of the year.

Q. All right, and did not that renegotiation continue throughout the entire year of 1944 up to the fall?

A. It was a long time in process. We prepared a complete report of all of the government operations and submitted them for approval. It is my recollection it was something like a year before it came back.

Q. Now, was that a reason, in addition to that given by you on cross-examination, why——

Mr. Marcussen (Interposing): Object to the question on the grounds that it is leading.

The Court: Objection sustained.

Mr. Smallpage: All right.

(Testimony of George Rollin Goold.)

Q. (By Mr. Smallpage): During the year 1944, what was the condition of the company with respect to moneys necessary to carry on its business?

A. We were carrying on considerable work, and we were not taking any money out of the business because of the fact there was a lot of war work in progress, and a lot more to come along. At the time we had the Wold—the liability on the Wold job, [183] my borrowing capacity was about exhausted. The result was that we needed all the capital we could get to carry on operations with the pay rolls.

Q. Did either one or both of these two factors, to-wit, the pendency——

Mr. Marcussen (Interposing): Object to the question on the ground that it is leading.

The Court: Let counsel get a little bit further along in the question. Go ahead.

Mr. Smallpage: I will repeat the question.

Q. (By Mr. Smallpage): Did either one of these two factors, the pendency of the renegotiation proceedings during the year 1943 and '44, and the shortage of money for operating capital in your business influence you in the question of requiring a payment upon this note from your son?

A. Quite materially. We wanted to keep just as liquid as possible, and because of those factors we didn't have a definite knowledge of the amount of money which was to be paid on the note, because of the percentage of profits. There were too many

(Testimony of George Rollin Goold.)

your own operations and continue the arrangement you had made regardless of income tax consequences, if that is what you wanted to do?

A. We expected to continue the operation, there was no [186] idea of cessation of the operation, we expected to continue the operation, but the accounting of the operation was something, and is still something that was in the balance, as I understand.

Q. Regardless of the income tax outcome, you continued to have your son in partnership with you?

A. It was my plan and still is my plan to have him in partnership.

Q. And to continue on with your agreement, is that the idea, that he would pay for his interest?

A. Not if this whole thing is set aside.

Q. Why not?

A. If the whole thing is set aside, we would have to start in all over again and work out a plan by which he can acquire an interest.

Q. Did your counsel ever tell you that the disposition of your income tax liability for any of these years would require that this transaction with your son be set aside? Did you ever receive advice to that effect?

A. I believe I did, yes. If I didn't, I probably figured it out myself, if the whole transaction was set aside, that——

The Court: At any rate, that is your reason, isn't it?

The Witness: Yes, sir.

(Testimony of George Rollin Goold.)

The Court: All right.

Q. (By Mr. Marcussen): [187] And it was Mr. Smallpage that advised you to that effect, is that correct?

Mr. Smallpage: Just a minute!

A. Advised me to the effect——?

Q. (By Mr. Marcussen): That this would all have to be set aside?

A. I couldn't say definitely whether Mr. Smallpage said that or not.

Q. Do you have any other attorney that advised you?

Mr. Smallpage: Just a minute! To which we object.

The Court: The witness said either his attorney advised him, or he thought it up himself. That was his testimony.

The Witness: Yes.

Mr. Smallpage: I would like to have an explanation from counsel what he means by "all set aside."

Mr. Marcussen: I think I have identified it in the record.

Q. (By Mr. Marcussen): I mean this transaction that has been entered into between you and your son?

The Court: I think the witness himself used the phrase "set aside." Go ahead.

The Witness: And the question is addressed to me now?

Mr. Marcussen: No, no question. Just a moment.

Q. (By Mr. Marcussen): [188] Do you recall

(Testimony of George Rollin Goold.)

whether your attorney advised you that if this were held to be a partnership, rather, if the government would not recognize the partnership, that it would be to your advantage to undo this transaction if you could? Did he ever tell you that?

A. I didn't have to have anybody tell me because I had the figures in front of me, when the government sent in the request, the demand for revision of the income tax returns on the basis that I was to contribute, and take back the entire ownership, and contribute some sixteen or seventeen thousand dollars, and at the same time my son receiving notice that he was to be refunded some twenty-three or twenty-four thousand dollars because of the fact the partnership had been set aside.

Q. And was it your understanding that——

A. (Interposing): I think those letters are in our file.

Q. Was it your understanding that the government was actually attempting to set aside the partnership and dissolve the partnership?

A. I don't think there was any question of it, it was so set forth in the letter. I would believe that was the only basis on which they would reaccount the matter.

Q. During the year 1945 was your credit with the bank still good? A. 1945? [189]

Q. Yes.

A. My credit has been good at the bank at all times as far as I know for any amount that the banks were able to loan.

(Testimony of George Rollin Goold.)

Q. And you have always been able to borrow substantial amounts, have you, from the bank?

A. Unless I was overdrawn, unless, I mean, I was up to my borrowing limit. On several occasions—for your information about bank loans, on one occasion my banker, at that time the Stockton First National Bank, had a loan limit of $50,000. At the time that this Goold and Downer operation was set up—this occurs to me now—I could borrow no more money from them, and I was taken by the hand and led down to the bank on the corner, and my banker recommended to the other bank (and I was not a customer), that they lend me an additional sum of money which was required to finance the Goold and Downer operations.

Q. Your credit has always been good, and it is good now?

A. As long as it has not been exhausted.

Q. It is good for substantial amounts at the bank right now?

A. At the present time.

Q. How much could you go to the bank right now and borrow?

A. I don't know. I have never tried.

Q. What is the largest amount you tried to borrow?

Mr. Smallpage: Objected to as immaterial.

The Court: What is the materiality, aside from the [190] testimony of the man that his credit has been good?

(Testimony of George Rollin Goold.)

Mr. Marcussen: I will withdraw the question, if your Honor please.

The Court: Yes.

Q. (By Mr. Marcussen): Now, after the profits for all of these years from these operations were ascertained you knew they had been substantial, didn't you, for 1943, '44, '45 and '46?

A. The profits were substantial, yes, sir.

Q. Yes, sir. A. From the operation.

Q. And that your son's half would be substantial?

A. I didn't know whether the son had a half or not.

Q. Well, if he did, why, the half would be substantial, wouldn't it?

A. If it was a substantial earning, if he had half, it would be substantial, that is right, yes.

Q. And you followed your attorney's advice all along here in this original transaction and sale to your son, and I think you have testified here in substance that you followed his advice all the way through. Did you ever depart from his advice in any particular on this transaction?

A. For the moment I can't recall any particular instance.

Q. Yes.

A. This attorney has been my attorney all during these [191] operations.

Q. Yes. This note that your son gave you, in whose possession was that note? A. Mine.

(Testimony of George Rollin Goold.)

Q. All during these years? A. Yes.

Q. How come that your attorney and your accountant have been making endorsements on it? Didn't they keep it in their office?

A. I don't believe it was ever out of my office, except possibly for those purposes of endorsement that occurred, or something.

Q. And did you surrender it to them, or did they come and ask you for it?

A. I can't answer that, I don't know.

Q. Now, did you ever consider the possibility——

A. (Interposing): I would like to answer that by saying that my papers have been taken out of my office by so many different people, accountants, the Tax Bureau and attorneys, that at the present moment I haven't any idea where half of them are. As far as the note is concerned, I don't believe that the note was ever out of my possession except for purposes of endorsement that were done by counsel.

Q. Yes. After the profits were ascertained, did you ever give any consideration to permitting your son to pay this [192] by having him merely assign to you his share of the profits in the business?

Mr. Smallpage: To which we object, unless counsel specifies the year.

The Court: Well, is this omitted cross-examination? This is the second set of cross-examination I have permitted you to——

Mr. Marcussen (Interposing): He has gone into the matter, the matter was gone into on redirect,

(Testimony of George Rollin Goold.)

if your Honor please, as to why he didn't make payments.

The Court: Well, on matters that were covered by redirect that were at all new, I take it you can go into, but I didn't know this was——

Mr. Marcussen (Interposing): Very well, I will withdraw the question, your Honor.

No further questions.

Mr. Smallpage: That is all, Mr. Goold.

The Court: That is all.

Mr. Smallpage: Just one question, Mr. Goold.

May I have permission? I overlooked it entirely, your Honor.

Redirect Examination

By Mr. Smallpage:

Q. In your opinion, assuming that your son was not a partner interested with you in the business but was purely a [193] salaried employee, during the year 1943 what do you consider his services were worth?

A. Well, for similar services, superintendents and managers are paid anywhere from ten to fifteen thousand dollars a year for operations of this magnitude.

Mr. Smallpage: That is all.

The Court: Cross-examine?

Mr. Marcussen: No further cross-examination.

(Witness excused.)

Mr. Smallpage: That is all. Petitioner rests.

The Court: No further testimony?

Mr. Smallpage: No.

The Court: Call your first witness.

Mr. Smallpage: Will Mr. Goold remain, or can he remain?

Mr. Marcussen: That is all right.

If your Honor please, I would like to offer next in order as Respondent's Exhibit next in order, the 1942 Joint Income Tax Return of Everett R. and Elizabeth F. Goold.

The Court: Admitted in evidence.

The Clerk: Exhibit Y.

(The Income Tax Return referred to was marked and received in evidence as Respondent's Exhibit Y.)

Mr. Marcussen: And is it stipulated that Everett R. is the father of the Petitioner, and Elizabeth is the mother? [194]

Mr. Smallpage: No, that is the Petitioner and wife.

Mr. Marcussen: Oh, I beg your pardon, that it is the Petitioner. Thank you for the correction.

BRUCE McCUBBIN

called as a witness for an on behalf of the Respondent, having been first duly sworn, was examined and testified as follows:

Direct Examination

The Clerk: State your name and address.

The Court: Your name is McCubbin, you are

(Testimony of Bruce McCubbin.)

an Internal Revenue Agent, is that correct, in the Stockton District?

The Witness: Yes.

The Court: Go ahead.

Q. (By Mr. Marcussen): In the course of the exercise of your duties, did you have occasion to investigate the income tax liability of Mr. Rolly Goold? A. I did.

Q. And in the course of that investigation, did you have talks with him about his liability from time to time? A. I did.

Q. And when did you first undertake this investigation?

A. As I remember, the investigation of the various joint ventures in which he was interested in was commenced about [195] either January or February, 1945, very early in the year.

Q. And is that the time that you began also to investigate Rolly Goold's income tax liability for the year 1943? A. That is right.

Q. And do you recall approximately when it was in the course of your investigation that you had a conference with, or a conversation with Mr. Rolly Goold?

A. I had various conversations with Mr. Goold from the first day I commenced the investigation until the investigation was finally completed.

Q. Did you have any conversation with him about the items on Exhibit 1, which is the Bill of Sale?

(Testimony of Bruce McCubbin.)

Mr. Smallpage: To which we object upon the ground that the question is leading.

The Court: Ask him whether he had any conversations.

Q. (By Mr. Marcussen): Did you?

The Court: Did you have any conversations?

A. I did.

Q. (By Mr. Marcussen): I hand you Exhibit 1-A, and ask you whether those are the items you had a conversation with him about.

Mr. Smallpage: To which we object upon the ground that is leading.

The Court: Sustained. [196]

Mr. Smallpage: And I ask that the document be taken from the witness' inspection.

Mr. Marcussen: I don't see why he can't see an exhibit that has been offered in evidence. I am merely identifying the conversation, that is all.

The Court: Now, Mr. McCubbin, state whether or not you and Rolly Goold ever had a conversation with regard to the Exhibit which is before you.

The Witness: We did.

Mr. Marcussen: Yes.

The Court: Now, what was that conversation?

Mr. Smallpage: To which we object upon the ground the proper foundation has not been laid, the time, place, the people present.

The Court: I will withdraw the question because it is improper for me to participate.

Mr. Marcussen: I will restate the question.

(Testimony of Bruce McCubbin.)

Q. (By Mr. Marcussen): Will you state what conversation you had with him about those items, please?

Mr. Smallpage: To which we object upon the ground the proper foundation has not been laid, two grounds, first, the people present, time and place, and for the further ground that this question is obviously for the purpose of discrediting Mr. Rolly Goold. [197]

The Court: Objection overruled. You may answer, Mr. McCubbin.

A. As I remember, I asked Mr. Good how these items were arrived at, and how their values were determined. To my best recollection, he stated that at that time they were estimated, they were the closest figures obtainable at that time.

Does that answer the question?

Q. (By Mr. Marcussen): Did you have any conversation with Mr. Goold at all about the note that his son had given him to pay for those items?

A. I did.

Q. What conversation did you have with him about that?

Mr. Smallpage: May it be understood that my objection as to the time, place and people present is interposed to that question?

The Court: The same ruling. Go ahead.

A. I asked Mr. Goold if his son had ever made any payments on account of this note. He stated, "no," he had not, he didn't expect him to make any payments on the note.

(Testimony of Bruce McCubbin.)

Mr. Marcussen: Will you speak up a little bit?

The Witness: I asked Mr. Goold if his son had ever made any payments on this note, Mr. Goold stated, "no," he had not, that he didn't expect his son to make any direct payments because the note provided for payments of 25 per cent of the [198] anticipated profits in these various joint ventures which would be applied against the note.

Mr. Smallpage: Would you give me your Reporter's notation where that answer came, please?

The Reporter: Page 50.

Q. (By Mr. Marcussen): Did he say anything else?

A. I asked him—I don't remember exactly the questions that I asked him, but I do know that Mr. Goold——

Mr. Smallpage (Interposing): Just a minute! To which we object upon the statement of the witness that he doesn't remember the questions, that he——

The Court (Interposing): Objection overruled.

State what you know, Mr. McCubbin.

The Witness: I do know that——

Mr. Smallpage (Interposing): May I take an exception to that, please?

The Court: Exception noted.

The Witness: I do know that Mr. Goold made the same statement to me that he has made here, that he couldn't rely on all the figures, and the records were there, he let the records speak for

(Testimony of Bruce McCubbin.)

themselves, and he hesitated to answer a direct question in a definite manner for the reason that he was not familiar with income tax law and procedure, and he might get himself in a trap as far as his tax liability was concerned. [199]

The Court: With regard to the last part of that answer, how is it material, Mr. Marcussen?

Mr. Marcussen: The materiality, if your Honor please, is that it shows that the Petitioner is relying completely on counsel, it shows a knowledge on his part, that something is attempted to be done here, and he doesn't want to be led into any traps. Now, I think a statement of that kind is exceedingly material.

The Court: Go ahead. Any other questions?

Q. (By Mr. Marcussen): Now, did he say anything further about payments on the note, that you can recall?

A. I don't remember any further statements made by him, or any other questions asked by me in regard to this matter.

Mr. Smallpage: May I see the report, please?

Mr. Marcussen: No, I am not going to put it all in.

Mr. Smallpage: Well, you will put——

Mr. Marcussen: Well, let's not argue about it. Will you please read it?

Mr. Smallpage (Examining document).

Mr. Marcussen: Excuse me, your Honor, for raising my voice.

(Testimony of Bruce McCubbin.)

Q. (By Mr. Marcussen): Now, I call your attention here to two paragraphs in this report, which is a report of a technical advisor, the [200] paragraphs being on pages 6 and 7, and ask you just to read that over, this first paragraph.

The Court: Is this shown to the witness to refresh his memory?

Mr. Marcussen: Yes, your Honor.

Mr. Smallpage: And it is being shown to impeach his own witness.

The Court: Go ahead, Mr. McCubbin.

Mr. Marcussen: Just read it, don't read it out loud, just read it, this first part of the first paragraph on page 6.

Q. (By Mr. Marcussen): Now, does that refresh your recollection about anything that Mr. Goold told you about the prospects of payment on that note?

Mr. Smallpage: To which we except.

The Court: All right, state your objection.

Mr. Smallpage: To which we object upon the ground that the document shown to the witness is a typewritten document, it doesn't purport to be signed by the witness, is an obvious attempt to impeach the witness without the proper foundation being laid.

The Court: Objection overruled.

This document was given to you, Mr. McCubbin, for the purpose of refreshing your recollection. You are asked now to testify not to what this docu-

(Testimony of Bruce McCubbin.)

ment says, but upon the recollection [201] that you have yourself independently of this document, which it refreshes in your mind, if it does.

Mr. Marcussen: That is correct.

The Court: Now, do you have such a recollection refreshed by this document?

Mr. Smallpage: May I examine the document, your Honor, to ascertain whether or not this witness signed that document, or prepared it, or was it prepared by somebody else?

Mr. Marcussen: I will identify the document further, if you wish.

The Court: Counsel can examine it, yes, I should think.

Mr. Smallpage: In other words, if I understand the law correctly—if not your Honor will correct me—I believe that a witness can only look at such document as he himself prepared for the purpose of refreshing his recollection, or one that was prepared under his direction. I asked counsel to let me look at the rest of the report——

Mr. Marcussen (Interposing): I will withdraw the question at this time, if your Honor please.

The Court: The question is withdrawn.

Mr. Marcussen: And ask leave to terminate the examination of the witness at this time, and to put on another witness that will identify this document.

The Court: Well, do you want to continue with the [202] direct examination of this witness on other matters?

(Testimony of Bruce McCubbin.)

Mr. Marcussen: No, your Honor.

The Court: Are you through with him?

Mr. Marcussen: I am through with him.

The Court: Cross-examine.

Mr. Smallpage: No questions.

Mr. Marcussen: All right. Step down.

The Court: That is all, Mr. McCubbin.

(Witness excused.)

Mr. Marcussen: Mr. Wilker.

Whereupon,

WILLIAM G. WILKER

called as a witness for and on behalf of the Respondent, having been first duly sworn, was examined and testified as follows:

Direct Examination

The Clerk: State your name and address.

The Witness: William G. Wilker.

Q. (By Mr. Marcussen): What is your occupation, Mr. Wilker?

A. Conferee of the Technical Staff.

Q. Of the Bureau of Internal Revenue?

A. Of the Bureau of Internal Revenue.

Q. And will you state briefly what are your duties as a Conferee on the Technical Staff?

A. We invite taxpayers to conferences for the purpose of [203] discussing the matters in the case, and arranging a settlement, if possible.

Q. Do you also prepare reports in the course of your duties?

(Testimony of William G. Wilker.)

A. Yes, as a consequence we prepare a report of what we have done.

Q. Yes. Do you recall preparing a report in connection with the liability of the Petitioners in this case for the year 1943? A. I do.

Q. I hand you this file in which is contained——

Mr. Smallpage (Interposing): To which we object upon the grounds of immateriality. If counsel desires to introduce it through the witness, that is proper, but a report cannot be introduced in evidence as such.

Mr. Marcussen: I am not offering this in evidence, I don't propose to.

The Court: Well, I am at a loss to know what the question is leading to, then, Mr. Marcussen, the identification of a document which is not to be introduced in evidence.

Mr. Marcussen: If your Honor please, this is the same document which I handed to the preceding witness, and the document is a document which was made by Mr. Wilker. This document contains a quotation from a document prepared by Mr. McCubbin, and I am simply going to identify it by this witness, [204] that quotation, and then I am going to take it to Mr. McCubbin and ask him whether he recognizes it, have it further identified, and then present it to Mr. McCubbin and ask him whether it refreshes his recollection about a conversation he had, not with the taxpayer, but with the taxpayer's father, Mr. Rolly Goold.

(Testimony of William G. Wilker.)

The Court: Well, you are proving by this witness, then, that a quotation in the document is a quotation from some matter prepared by Mr. McCubbin himself?

Mr. Marcussen: Yes.

The Court: I see. All right, proceed.

Mr. Smallpage: To which we object upon the ground that that calls for a conclusion of the witness, and the original document is the document that should be produced. The petitioner here is placed in a most disadvantageous position when a government witness is permitted to say, who did not have the talk with the taxpayer, that a document which he holds in his hands is a copy of another document. Until they can show the loss of that other document they are not entitled to show a copy of it, that is fundamental law.

The Court: Objection overruled.

Mr. Marcussen: Very well.

The Court: You may answer, Mr. Wilker.

Mr. Smallpage: Exception, please.

The Court: Exception noted.

Mr. Smallpage: And in order that my objection might [205] be made specific, it is because the proper foundation has not been laid in that it has not been shown that the document from which the alleged quotation was taken is missing and cannot be produced for examination.

The Court: Go ahead.

Q. (By Mr. Marcussen): Now I call your at-

(Testimony of William G. Wilker.)

tention to one of the documents contained in this file, and ask you whether the one referred to is a report prepared by you in connection with the liability of this taxpayer for the year 1943?

A. (Examining document): It is.

Q. Is that your signature appearing on page 16 of the report? A. Yes, sir.

Mr. Smallpage: To which we object upon the ground it is immaterial, what his report is concerning the liability of this taxpayer.

The Court: Overruled.

Mr. Smallpage: It is understood, I also assume, that in a conference held with the representative of the government, that the statements made there which involve compromises and cross questions are certainly not to be used against the witness, unless he himself had a transcription in shorthand, or it was by some other recognized means taken down.

The Court: Go ahead. [206]

Mr. Marcussen: Now, if your Honor please——

The Court (Interposing): Let's get the point of this.

Mr. Marcussen: I must make a statement to clarify the record at this point, if your Honor will indulge me.

The Court: I don't think the record needs clarification, because I think the record is clear. The purpose of this is merely to identify as a copy, from something that Mr. McCubbin wrote, two paragraphs in this document which is before this witness.

(Testimony of William G. Wilker.)

Mr. Marcussen: Yes. I also wish the record to show, your Honor, that this is not a statement made by the taxpayer in any attempt to compromise his liability at all.

The Court: All right, go ahead. As I said before, the record doesn't need it because——

Mr. Smallpage (Interposing): Well then, the objection is it is hearsay.

The Court: Go ahead.

Q. (By Mr. Marcussen): I call your attention to page 6 of this document, and I call your attention to the paragraph beginning slightly below the middle of the page, which reads——

Mr. Smallpage (Interposing): Just a minute. Let him read it himself.

Q. (By Mr. Marcussen): [207] I will ask you to read it. A. "The above mentioned——'

Q. (Interposing): No.

The Court: No.

A. "——Revenue Agent's report——

Q. (By Mr. Marcussen) (Interposing): Just read it silently, Mr. Wilker.

A. Oh, excuse me. I am sorry, I am sorry.

Q. Have you read it? A. Yes.

Mr. Marcussen: Do you want to see it, counsel?

Mr. Smallpage: Yes, certainly, I want to see the whole document.

Q. (By Mr. Marcussen): I ask you to state——

Mr. Smallpage (Interposing): Just a minute! Let me read the whole document.

(Testimony of William G. Wilker.)

Mr. Marcussen: No, the document is not in evidence. The document consists of sixteen pages. It is a confidential document. I am merely establishing a quotation from a particular page, your Honor.

Mr. Smallpage: It would seem to me, your Honor, that if any portion of this document can be shown to the witness it should be shown to the counsel for the Petitioner.

The Court: Go ahead. The only purpose of this, as [208] I see it, is to get two paragraphs identified as from a letter, or a statement, or a document prepared by Mr. McCubbin. That is the only relevancy of this at all.

Mr. Smallpage: Alleged to have been prepared.

The Court: Well, that is all right, alleged to have been. I don't know. Let the witness testify. The rest of the document is irrelevant and immaterial, we are not interested in it.

I don't take it that counsel for the government is interested in it.

Mr. Marcussen: That is right.

The Court: The rest of the document would be totally irrelevant and immaterial, because, as you pointed out, the proceedings before the Conferee, before any settlement proceedings, are as though they were nothing in the proceeding here. We are not interested in any statements made or in any action taken by way of settlement.

Mr. Smallpage: All right. Then is this not fair, your Honor, that before they produce a copy made

(Testimony of William G. Wilker.)

by a third person, why don't they produce the report itself? It must be in the files of the government. I don't think that is an unfair request. Why don't they produce Mr. McCubbin's own report? I have no objection to that.

The Court: Let's go ahead. The point of argument here is with regard to this witness' examination as to those [209] paragraphs.

Now proceed, Mr. Marcussen.

Q. (By Mr. Marcussen): Now I would like to ask you, Mr. Wilker, about these two paragraphs which are in quotation marks, and ask you where you got those two paragraphs that are quoted on pages 6 and 7 of this report.

A. From a report by the Revenue Agent.

Q. And who was the Revenue Agent?

A. Mr. McCubbin.

Q. Yes. And at the time that you inserted these two paragraphs from that Revenue Agent's report in this report, did you have the Revenue Agent's report before you? A. I did.

Q. And it was taken from that? A. Yes.

Q. Do you know where that report is now?

A. No.

Mr. Marcussen: That is all that I have to ask of this witness.

The Court: That is all, unless there is cross examination.

Mr. Smallpage: Yes, I would like to know what became——

(Testimony of William G. Wilker.)

The Court (Interposing): All right.

Cross-Examination

By Mr. Smallpage:

Q. Mr. Witness, how voluminous was that report of Mr. McCubbin's from which he took this extract?

A. Oh, I don't recall.

Q. Well, was it four pages or ten pages?

A. Oh, more likely ten, but I am not certain.

Q. It was a bound volume, or a bound report, was it not?

A. Well, no, not bound, that is, it was a sheaf of papers fastened together, I presume, with a staple or fastener.

Q. It is a part of the government records, in so far as this transaction is concerned?

A. It was when I had it.

Q. And you treated it as such, did you not?

A. Oh, yes.

Q. Now, what did you do with it?

A. I associated it with the file when I transmitted the file to my superiors.

Q. That is to say, it was filed with this document of which this is alleged to be a copy, is that right? A. Pardon me?

Q. It was filed with, or associated with you—by the way, what do you mean by the word "associated" by you?

A. Put into the files, placed with the docket, or with the folder that I had for the case.

Q. And was it stapled at the time? [211]

(Testimony of William G. Wilker.)

A. No.

Q. But it was at least put in there in the same way your report was?

A. Well, it was kept separate, my report was, upon the Petitioner, the partnership report was a separate document, kept separate from that file, that is, it was not bound in a jacket like this.

Q. All right, but you put it in the jacket when you returned it? A. Oh, yes; oh, yes.

Q. To whom did you return it?

A. It went to my superior.

Q. Who is that?

A. Mr. Lowder and Mr. Harlacher, from there it would go to the file clerks.

Q. Have you made any search to ascertain whether or not that document is not in the files at the present time? A. No.

Q. Has anyone ever requested of you that you make a search to ascertain? A. No.

Q. Now, in the preparation of your report, did you dictate that particular paragraph, or did you give Mr. McCubbin's alleged report to a stenographer and tell her to make a transcription? [212]

A. I told her to make a transcription and checked it.

Q. And is that the only portion of his report that is included?

Mr. Marcussen: Object to that, it has no materiality, if your Honor please.

(Testimony of William G. Wilker.)

Q. (By Mr. Smallpage): That is included in this document? A. As a quotation?

Mr. Marcussen: Objection on the ground it is immaterial, your Honor, and going to take time.

The Witness: It is the only part I see quoted.

The Court: All right, any other questions.

Mr. Smallpage: That is all.

The Court: That is all.

Mr. Marcussen: Now, just a moment, Mr. Wilker.

Redirect Examination

By Mr. Marcussen:

Q. You testified that the Revenue Agent's report was returned to the file. Is that the same as this file that is involved in this proceeding?

A. When I said to the files, I meant to our file room in our office room. From there I can imagine that it was returned to the Revenue Agent's office.

Q. I see.

And I think you testified that that was a report of [213] the partnership, the analysis of the partnership income?

A. Yes, yes, this was on the partnership.

Q. Well, in the ordinary course of Bureau procedure, would that document be placed in this file, or would it be returned to the partnership file?

A. It was returned to the partnership file.

Q. Yes. And do you recall whether I asked you to look for that in this file? Have you made a search?

(Testimony of William G. Wilker.)

A. Yes, I have looked in this file.

Q. And did you find it? A. No.

Mr. Marcussen: That is all.

The Court: That is all, sir.

Mr. Smallpage: Just one minute.

Recross-Examination

By Mr. Smallpage:

Q. Mr. Witness, at the time that Mr. Scott and Mr. Goold and his son and myself were in your office, did you at that time have Mr. McCubbin's report before you?

Mr. Marcussen: Object to it on the grounds it is immaterial. We are not concerned about any conferences that took place.

The Court: I don't think it is material.

Mr. Marcussen: In the Technical Staff, that is the whole point. [214]

The Court: I will sustain the objection.

Q. (By Mr. Smallpage): Did you at the time that we had that conference make any statement to us individually or collectively that Mr. Goold had made any statement to Mr. McCubbin with respect to the terms under which he had sold this property to his son?

Mr. Marcussen: Objection on the grounds that it is not proper cross-examination, not within the scope of the direct.

The Court: I will sustain the objection.

Mr. Smallpage: That is all.

The Court: That is all, sir.

(Witness excused.)

Mr. Marcussen: Recall Mr. McCubbin, please.

Whereupon,

BRUCE McCUBBIN,

recalled as a witness for and on behalf of the Respondent, having been previously sworn, was examined and testified further as follows:

Direct Examination

By Mr. Marcussen:

Q. Now, Mr. McCubbin, I want to call your attention to page 6 of this report which has been identified by the preceding witness, and I call your attention to the second last paragraph on the page which appears in quotation marks, and is the first of the two paragraphs which the preceding witness identified, and I ask you——

The Court: (Interposing) You might just ask him whether that refreshes his recollection or not.

Q. (By Mr. Marcussen): Yes, whether that refreshes your recollection as to any conversation that you had with Rolly Goold as to the subject of making payments on the note?

Mr. Smallpage: Just a minute, if your Honor please.

The Court: All right.

Mr. Smallpage: That document should never have been shown to this witness until I have had an

(Testimony of Bruce McCubbin.)

opportunity to object to it. It is an attempt to impeach his own witness without the proper foundation being laid. The phraseology contained in those two paragraphs is at distinct variance with what the witness testified to on direct examination. Now, it is most assuredly unfair to this witness to be presented with a document which he himself does not know is a quotation from a report which was made by him, and in view of the fact that the government has shown no attempt, no effort whatsoever to go over to their file room and get the other document which certainly must be in existence, the original report from which that document that extract was taken is in existence, it is right here. We have produced for the government some, I think, 50 exhibits. We only had three or four. They required and asked us repeatedly up to Saturday to produce different exhibits. Now, certainly [216] they have had the opportunity to go over there and bring that partnership report here, and if they wanted to refresh Mr. McCubbin's mind, they could have had it here to do so, and to rely upon an alleged copy made by a stenographer who was told to copy a paragraph is most unfair to the witness, and does not constitute the proper foundation for an impeachment of their own witness. That is exactly what this is.

The Court: Objection overruled.

Does this refresh your recollection?

The Witness: It does.

(Testimony of Bruce McCubbin.)

Q. (By Mr. Marcussen): Now, can you testify after your recollection is refreshed as to what Mr. Rolly Goold did tell you about payments on the note?

Mr. Smallpage: Just a minute! To which we object upon the ground that the question has been asked and answered in direct conversation.

The Court: Overruled.

A. Well, he stated he had received——

The Court: (Interposing) Now you are testifying from your own recollection?

Mr. Smallpage: Listen, let's remove the document from the witness'——

The Court: (Interposing) You are not testifying from any document, it is just what you remember now from your own [217] recollection of it.

Mr. Smallpage: Let's put it up here.

Mr. Marcussen: Let's leave it here. I have covered the page.

The Witness: As I remember, Mr. Goold stated that he had received no payments on the note, and he didn't expect to receive any direct payments on the note. As I recollect, Mr. Goold stated that he at that time had received no payments on the note, and did not expect to receive any payments on the note.

Q. (By Mr. Marcussen): Now, is there any doubt about it in your mind at all, as to whether he made that statement to you?

A. No, there never was.

(Testimony of Bruce McCubbin.)

Mr. Marcussen: That is all.

Mr. Smallpage: Will you please refer back to the witness' testimony that he gave on direct examination, wherein he stated that Mr. Goold did not expect his son to make payments on the note, but his money on the note was to come out of his son's share of the profits of the business? Please refer to that testimony that the witness gave.

The Court: Was that the part that you asked the Reporter to make a notation on?

Mr. Smallpage: It is right about in there, if your Honor recalls that testimony.

The Court: Well, the testimony will appear when the [218] transcript is made up. You may cross-examine the witness on the assumption that he did make the statement.

Mr. Smallpage: Thank you. I did not want to make cross-examination on an erroneous assumption of fact.

The Court: All right.

Mr. Marcussen: Now, will it be understood that you will state to the witness what you understood his statement was?

Mr. Smallpage: Please refer back to your notes, page 50.

The Court: I don't know if the Reporter can find it. Do you think you can?

(The testimony referred to was read by the Reporter, as follows:)

(Testimony of Bruce McCubbin.)

"Answer: I asked Mr. Goold if his son had ever made any payments on account of this note. He stated, 'no,' he had not, he did not expect him to make any payments on the note."

The Court: All right, that is enough. Your assumption is correct.

Mr. Smallpage: I thought it was.

Cross-Examination

By Mr. Smallpage:

Q. Now, that is a fact what he said, isn't it, Mr. McCubbin, your testimony is true and correct as given in your [219] direct examination and as reported by this young lady?

A. That is correct, but I still believe that both of my statements——

Q. (Interposing) Just a minute!

The Court: Not what you believe, what he said. Now, you said once that he said he didn't expect any direct payments because he was going to get payment out of the profits.

The Witness: That is right.

The Court: All right, it is not what you believe, it is what he said.

The Witness: All right.

Q. (By Mr. Smallpage): Now, Mr. McCubbin, in your report you never made any contention that this transaction between Goold and his son was a gift and not a purchase, did you?

Mr. Marcussen: Object to that on the grounds it is improper cross-examination.

(Testimony of Bruce McCubbin.)

The Court: Sustained.

Mr. Smallpage: All right, I call for the report.

The Court: All right, it does not make any difference what Mr. McCubbin contended with regard to it, we are interested in what the facts are.

Mr. Smallpage: That is right. All right.

The Court: Yes, it is irrelevant.

Mr. Smallpage: The point I want to make is this: [220] That is if he had received any evidence to the effect that this was a gift and not a purchase transaction, he should have so reported it in his return, which he did not, and I submit it is a matter of fact that he made no such return. I am not privileged, as I understand the law, to examine these Internal Revenue Agents' reports. That is correct, is it not, your Honor? [221]

* * *

Mr. Smallpage: May the record show, in response to the petition of the Respondent, Petitioner had ready here for examination as their witnesses, Mr. Snell, CPA, Accountant for the Petitioner, who prepared some of these exhibits, and also Mrs. Katharine Goold, the mother of the petitioner. [225]

* * *

[Title of Tax Court and Cause.]

CERTIFICATE

I, Victor S. Mersch, Clerk of The Tax Court of the United States do hereby certify that the foregoing documents, 1 to 17 inclusive, constitute and are all of the original papers and proceedings on file in my office as called for by the "Praecipe for Record" in the proceeding before The Tax Court of the United States entitled "E. R. Goold, Petitioner, v. Commissioner of Internal Revenue, Respondent," Docket No. 15072 and in which the petitioner in the Tax Court proceeding has initiated an appeal as above numbered and entitled, together with a true copy of the docket entries in said Tax Court proceeding, as the same appear in the official docket book in my office.

In testimony whereof, I hereunto set my hand and affix the seal of The Tax Court of the United States, at Washington, in the District of Columbia, this 7th day of July, 1949.

[Seal] VICTOR S. MERSCH,
Clerk, The Tax Court
of the United States.

[Endorsed]: No. 12296. United States Court of Appeals for the Ninth Circuit. E. R. Goold, Petitioner, vs. Commissioner of Internal Revenue, Respondent. Transcript of the Record. Upon Petition to Review a Decision of The Tax Court of the United States.

Filed July 21, 1949.

/s/ PAUL P. O'BRIEN,

Clerk of the United States Court of Appeals for the Ninth Circuit.

In the United States Court of Appeals
for the Ninth Circuit

No. 12296

E. R. GOOLD,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

STATEMENT OF POINTS AND DESIGNATION OF RECORD

Now Comes the petitioner, E. R. Goold, by his attorney as undersigned, and states that the points on which he intends to rely as to the relief sought in this proceeding for review of a decision of The Tax Court of the United States are, with reference to the petition for review hereinbefore filed with the said Tax Court, all of the assignments of error

numbered 1 to 4, inclusive, as set forth in section IV of the said petition for review, and the same are so adopted.

The said petitioner designates as material to the consideration of the review subject of this proceeding all those parts of the record described in the petitioner's Praecipe for Record under items 1 to 7, inclusive, of that document, this statement of points and designation of record, and exhibits 1-A, 2-B, 3-C, and 28 filed in the proceeding before The Tax Court of the United States at the hearing thereon March 28 and 29, 1948, all of which items and exhibits are properly to be included in the record to be printed in this proceeding. The petitioner also designates as material to the consideration of this review as part of the record to be printed, as stated above, the following described portions of stenographic transcript of the proceedings of the Division of The Tax Court of the United States held and had in this cause at San Francisco, California, on March 28 and 29, 1948, to-wit:

(1) The last four (4) lines of page 30;

(2) Beginning with line 17 on page 32, reading, "By Mr. Smallpage": to and including line 22 on page 47, reading, "A. There was not anything discussed on that.";

(3) Beginning with line 10 on page 48, reading, "Elizabeth Goold" to and including the last line on page 49;

(4) Beginning with line 10 on page 50, reading "Cross-Examination" to and including line 22 on page 51, reading, "A. He always has.";

(5) Lines 17 and 18 on page 56, reading "Cross-Examination by Mr. Marcussen:";

(6) Beginning with line 20 on page 58, reading, "Q. All right. Now I want to take you back to the first . . ." to and including line 20 on page 66, reading, "Mr. Marcussen: No, I am not.";

(7) Beginning with line 1 on page 72 to and including line 16 on page 119, reading, "A. I don't know.";

(8) Beginning with line 19 on page 121, reading, "C. E. Kennedy" to and including line 24 on page 121, reading, "Direct Examination.";

(9) Beginning with line 7 on page 124, reading, "By Mr. Smallpage:" to and including line 14 on page 125, reading, "in the partnership.";

(10) Beginning with line 22 on page 129, reading, "George Rollin Goold" to and including line 3 on page 195, reading, "Petitioner. Thank you for the correction.";

(11) Beginning with line 6 on page 195, reading, "Bruce McCubbin" to and including line 7 on page 221, reading, "The Court: Yes, the objection is sustained.";

(12) Beginning with line 14 on page 225, reading, "Mr. Smallpage: May the record show, in response to . . ." to and including line 18 on page 225, reading, "Mrs. Katharine Goold, the mother of the petitioner."

Dated: July 29, 1949.

/s/ LAFAYETTE J. SMALLPAGE,
Attorney for the Petitioner.

[Endorsed]: Filed July 30, 1949.

No. 12,296

IN THE

United States Court of Appeals

For the Ninth Circuit

E. R. GOOLD,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Upon Petition to Review a Decision of the Tax Court of the United States.

OPENING BRIEF OF PETITIONER.

LAFAYETTE J. SMALLPAGE,
511 Stockton Savings & Loan Bank Building, Stockton 5, California,
Attorney for Petitioner.

PERNAU-WALSH PRINTING CO., SAN FRANCISCO

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No. 12,296

IN THE

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For the Ninth Circuit

E. R. GOOLD,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Upon Petition to Review a Decision of the Tax Court of the United States.

OPENING BRIEF OF PETITIONER.

To the United States Court of Appeals, for the Ninth Circuit:

QUESTION ON APPEAL.

This is a petition to review a decision of the Tax Court of the United States confirming in part a determination by the respondent of deficiencies in income and victory taxes on the petitioner's 1943 income and victory tax return in the amount of $18,632.28, of which determination the Tax Court approved $17,793.84 as valid. (Tr. p. 52.)

JURISDICTION.

Jurisdiction of this Court of Appeals to review the decision is based on Sections 1141, 1142 and 1143 of the Internal Revenue Code (c. 2, 53 U.S. Statutes at L.).

The findings of fact and conclusions of law to which exceptions are taken in this petition are found in the memorandum of findings of fact and opinion of Judge Kern printed at pages 34 to 52 of the transcript of record.

QUESTIONS AT ISSUE.

The petitioner's assignments of error in his petition for review (Tr. p. 64) present two questions for consideration by this Court, namely:

(1) Question of fact.

Did the Tax Court err in its finding of fact from the evidence before it and the presumptions imposed by Section 172 of the Civil Code of the State of California that the petitioner did not acquire his interest in the partnership business of R. Goold & Son by purchase?

(2) Question of law.

Did the Tax Court err in finding that the petitioner's accrued California income tax on his income from the said partnership business was not deductible in computing his income subject to the victory tax in force for the calendar year 1943?

SUMMARY OF ARGUMENT.

(A) There are two questions presented herewith for review: First (one of fact), did Rollin Goold, father of petitioner (hereinafter designated "Father"), give or sell a one-half interest in his business, as of January 1943, to his son E. R. Goold (hereinafter designated "Son")? The Tax Court held that the transaction by which this one-half interest in the business was transferred was one of gift, and thus the earnings of the petitioner thereon are his separate property and taxable as such. Son claims that he purchased the interest from his Father, and thus his earnings are community property and taxable as such.

(B) The second question for review (one of law) is technical and will be discussed in the latter part of this brief.

(C) Tax Involved: The amount of tax in dispute on this appeal is in excess of $17,793.84, the petitioner contending that he is entitled to a refund of approximately $200.00.

(D) Statutes and Regulations: Citations, quotations and applicable statutory provisions and regulations interpretive of them will appear in the argument.

FIRST QUESTION.

Facts.

(A) At all times material to this proceeding, Son was married and living with his wife, Elizabeth—a resident of Stockton, California—and had as depend-

ents during the calendar year three daughters, together with a son born June 29, 1943. (Admission of respondent in his answer—Tr. p. 25.)

(B) Father Goold and Son were equal partners in a general contracting business, conducted under the name of R. Goold & Son. This fact is admitted by respondent. Son acquired his one-half interest therein on January 2, 1943, in consideration for which he gave his promissory note, originally in the principal sum of $100,000.00, bearing no interest, and payable out of 50% of Son's share of future earnings of the partnership. This principal sum of this note was subsequently reduced by endorsements to $70,741.00, in accordance with the agreement under which the partnership interest was acquired by Son. (Admission of respondent in his answer—Tr. p. 25.)

(C) Son and his wife returned their partnership income, fifty-fifty, as community property. Their basis for so doing is found in the California law of community property which holds that property acquired on the credit of community property estate is community property. The pertinent provisions of California law are set forth with citations of California cases in G.C.M. 13620, C.B. XIII-2 (1934), p. 179, over the signature of Hon. Robert H. Jackson, now associate justice of the Supreme Court of the United States. *Cf. opinion in Edwin C. F. Knowles,* 40 B.T.A. 861.

(D) A bill of sale was executed and delivered (Exhibit 1A, Tr. p. 55) which set forth in detail the

business assets which were the subject of the sale. The working papers given to counsel, who prepared the bill of sale for Father, had the word "estimate" set opposite the items designated upon the said paper and said bill of sale as "D", "E" and "F". The value of the other items were taken from the books of the business; these correspond directly with those book values thereof, with the exception of item "C" in which a mistake was made of no particular moment.

ARGUMENT.

(1) It is obvious that this transaction was either gift from Father of the community property of himself and his wife (Son's mother), or it was a sale thereof. In the argument of counsel for respondent, the latter inferentially admitted that the transaction was subject to considerable question as being one of gift, but that this fact could not be used in support of a deduction that the transaction was one of sale. This argument is obviously unsound.

(2) The fact that the parties particularly specified in this bill of sale the value of each item, with the proviso that with respect to those items of which an estimate was made an adjustment in the face amount of the note would be made to correspond with the true value thereof (Son's testimony, Tr. pp. 73 and 121—Father's testimony, Tr. pp. 147, 173 and 180), indicates an intent that this transaction should be one of sale rather than gift. The question before

the Court is the intention of the parties, Father and Son. Each has testified directly in the testimony that it was their intention to make a sale. (Son's testimony, Tr. pp. 71, 81, 117, 120 and 135—Father's testimony, Tr. pp. 139, 149, 150, 169 and 170.) A witness is presumed to tell the truth. However, this intention of mind is best shown by the subsequent acts of the parties. This brings to mind the old proverb, "The acts speak so loudly that one can not hear the spoken word." Counsel for respondent bases his argument upon the fallacious theory that even though all of the forms relating to a sale were complied with and all of the acts of the parties indicated a sale, that is proof positive that the parties had a "gift" transaction in mind—otherwise they would not have been so meticulous. To the mind of the writer of this brief, this is a ridiculous argument. It is conceded that Father wanted Son as a partner, and that the partnership was legally formed, and has been at all times carried on as such. (Respondent's answer, Tr. p. 25, paragraph 5(b).) Now, if Father desired to make a gift of this one-half interest, he could have done so and, simultaneously upon the receipt of that gift, Son could have converted that gift into community property by a simple declaration and transfer to his wife thereof (*O'Done v. Marzocchi,* 34 A.C. 499); thereafter, the tax would have been allocated exactly in the same manner as that for which he now appeals. Likewise, Father could have made a joint gift to Son and the latter's wife, and the same result would have followed. However, Father has testified repeatedly that

he had two children, Son and a daughter; that he did not desire to lessen the value of his estate by the gift of property to one; that it was for this reason he made a sale thereof, to the end that unless Son paid for the partnership interest so transferred, prior to the death of Father, the remaining unpaid portion of the note would constitute a claim in the estate for the benefit of all parties interested therein, including specifically first, his wife, and secondly, his children. (Tr. p. 20.) No gift report was made by Father at the time he made this transaction, which is indicative of the fact that both he, his Son and his counsel (legal and tax) did not have such a type of transaction in mind. The terms of payment which are out of the future profits of the business as earned by himself and Son are not unusual; in fact, it is quite the thing now-a-days to take a young man into business and allow him to purchase his share thereof through profits which are earned by himself and his Father. The Tax Court stated in its opinion that this was an unusual situation, indicating that the parties did not deal at arm's length—thus, it was a reasonable deduction that a gift was intended. The Tax Court is apparently not familiar with the facts of life as they exist at present. Certainly this Father and his only Son did not deal at arm's length. It is the testimony of Father and also that of Son (Son's testimony, Tr. pp. 117 and 118—Father's testimony, Tr. pp. 137 and 138), that as early as 1940, when the Father bought out his partner, Supplick, he requested Son to drop his business and come in and work with him, to the

end that if, in the future, they found themselves compatible that he, Father, would take Son into the business. For three years, Father worked alongside his Son. The latter, according to the testimony, finally became the manager of the business. (Tr. p. 70.) There is considerable evidence in the record concerning the value of Son's services—sufficient that the Tax Court held that as an employee his services were worth a minimum of $10,000.00 a year. (See Tax Court Opinion, Tr. p. 47.) Father was 61 years of age; he suffered from arthritis; he was away from business during the year of 1942 as long as nine weeks at a time. The parties were tremendously busy in carrying out war contracts for the Government. In 1942, Father discussed with mother the advisability of selling Son a one-half interest in this business. At that time, Father had other property, admittedly all community, to the value of some $81,000.00. His interest in the partnership was eventually valued at around $160,000.00. (Father's testimony, Tr. p. 180.) Father discussed the matter with Son. Son was obviously glad to have an opportunity to buy a one-half interest which would give him a security and continuity of financial relationship with his Father. Son was then 32 years of age (Tr. p. 68); he had four children and a wife; he of course had no moneys to pay upon the purchase price—such moneys would have to come from a share of his future earnings.

(3) Counsel for respondent commented in Court upon the fact that since the Son had no money or other financial resources, that this of itself indicated

that the transaction was a gift rather than a sale. We do not follow this argument. Father went to his attorney and to his tax consultant and asked them to prepare the necessary documents and submit a proposition which would not involve him in any tax liability. There is nothing unusual about this. Why should the government participate in any tax in a transaction of this kind which produces no new value? It is no crime for any taxpayer to handle his affairs in such a manner as will lessen his tax burden.

(4) The Tax Court adopted as a fact that the TRUE INTENT of Father was expressed in his testimony that he did not want to discriminate or prefer one child over the other. (Tr. p. 46.) The Court then proceeds upon most erroneous factual deductions. The Court states that if this transaction be deemed a gift, then, upon the death of Father it would be an advance made in contemplation of death and thus the daughter could legally be equalized in the distribution of the estate—a most fallacious reasoning. In the making of a gift prior to death, there must exist a definite intention on the part of the giver and receiver that the property transferred be considered as an advancement in case of death, and that intent must be in the handwriting of either the maker or receiver of the gift. (*Calif. Probate Code* Sec. 1050; *Estate of Rawnsley,* 94 A.C.A. 426, decided November 2, 1949.) There is herein absolutely not one iota of evidence to support such a deduction. If this be a gift, then Son will have received a preference—in the event of his Father's death—over his sister. Father, to avoid

that very situation, had the Son put in his estate a note to the full value of the interest transferred, so that upon his death, Son would owe the estate the value of this interest. Only in this manner could there be an equalization of the interest of daughter and Son upon the death of Father. But we can hear counsel for respondent ask this question: How about the fact that this note is payable out of profits? This Court will bear in mind that the amount of profits that is applicable to the note is one-half of the Son's share—or one-fourth of the total profits. We must assume that Son's services are worth considerable money, and that they materially have and will contribute to the firm's profits—in fact, Son is probably carrying most of the business load. The fact that the Tax Court, under attack from the government, was willing to allow him $10,000.00 yearly salary back in 1943, is proof thereof.

(5) It is presumed that the parties will follow the law. At the time of this transaction, it was, ever since has been and is now the law of California that the husband cannot make a gift of any portion of the community property of the wife and himself without the written consent of the wife.

Civil Code of the State of California, Section 172:

> "*Management of community personal property.* The husband has the management and control of the community personal property, with like absolute power of disposition, other than testamentary, as he has of his separate estate; provided, however, that he cannot make a gift of such com-

munity personal property or dispose of the same without a valuable consideration, or sell, convey or encumber the furniture, furnishings or fittings of the home, or the clothing or wearing apparel of the wife or minor children that is community, without the written consent of the wife."

(See case of *O'Done v. Marzocchi,* 34 A.C. 499, decided November 15, 1949, for California Court's latest interpretation of this section.)

(6) Father testified that at no time did he receive the consent of Mother. None was shown by the Commissioner. (Tr. p. 150.) Mother was in attendance both days of the trial, at the demand of the Commissioner. (Tr. p. 223). There is a well-recognized rule of evidence that testimony in possession of a party and not produced by him at the trial will be deemed to have been unfavorable to his position—thus, the Court should find, as a matter of evidence, that Mother did not consent to any alleged gift of this portion of the community property of herself and her husband—had Father intended to make such a transaction a gift—the same is void under the California rule above set forth.

(7) Elizabeth Goold—wife of Son—was called as a witness for the Government. (Tr. pp. 82 and 83.) On page 83, on cross-examination, Mrs. Goold, in response to the following question by Counsel: "Mrs. Goold, do you recall the time when your husband acquired an interest in your father-in-law's business?", stated: "Well, I heard him—he told me that he had a chance to, but that is about all. He doesn't discuss his business with me. * * * (page 84) * * * Well, he told me

that he would have to sign a note, to get the money to buy into his father's business, to pay for it out of the profits of the business, but other than that, I don't know anything about his business transactions."

(8) Let the Court consider: We have four witnesses testifying positively that it was the intention of the Father to make a sale of the interest to the Son. Two of them, Father and Son, were called on behalf of the Petitioner. One (wife of Petitioner) was called by Respondent, and the other called into attendance (Mother of Petitioner) by Respondent, was never used. We submit that the Government is bound by the testimony—actual and potential—of these two ladies; they were not called as hostile witnesses. Obviously, Elizabeth Goold told the truth in this matter. If Father had intended to make a gift to Son, unquestionably Son would have so told his wife, but repeatedly, in response to a direct examination by Government counsel, she stated no such gift was ever made to her knowledge.

(9) The Tax Court completely disregarded the community property laws of California. Are these Acts nullities in so far as the Federal Government is concerned? Could Son have ever set up against either Father or Mother his contention that this note was fiction—in the face of this positive law of California, that no member of the community can give away the assets thereof? We are positive that any Court and any Jury on this testimony would declare the transaction that of a sale.

(10) Respondent's counsel, as well as the Tax Court, made a point that no interest was chargeable upon this note. Banks at this time were only paying 1% on deposits; we believe that is true likewise up to the beginning of this year 1949. Son left all of his earnings in the business. *We cannot see wherein that is of any particular moment.* The business had use of the one-half of the Son's profits without any interest charge. The amount is so small that it isn't worthy of much comment.

(11) We do, however, come to that upon which counsel for respondent laid great stress and to which the Tax Court gave grave consideration: "Irregular endorsements upon the note". A failure upon the Father to insist that Son pay him upon the note, in accordance with the terms thereof, if not explained, would be evidence of the fact that Father did not intend to enforce payment thereof which, in turn, would be evidence of a gift. We concede that. We state that this is the only *prima facie* weak part of our case. It is, however, clearly explainable. During the years 1944 and 1945, Father did not collect from Son the latter's profit payment for the years 1943 and 1944. The fact that the Father did collect from the Son in cash, which went into his own bank account for the two years of 1945 and 1946 is proof that Father and Son both considered the transaction one of sale. (Tr. p. 81.) Government counsel and the Tax Court have absolutely overlooked and disregarded the collection of payments for these latter years, harping upon the non-payment for the other two

years—the reason for which, in the mind of the writer of this Brief, is clearly apparent.

(12) No moneys were endorsed upon the note nor collected by Father representing Son's share of the profits for the year 1943 operations. Why? The answer given by Father and Son is reasonable. (Son's testimony, Tr. pp. 126 and 127—Father's testimony, Tr. pp. 176 and 177.) In the Fall of 1943, the Government called upon them to renegotiate their war contracts, which constituted practically all of their 1943 business. (Tr. pp. 126, 127 and 188.) This renegotiation was not completed until the Fall of 1944. It is obvious to any practical-minded, impartial-minded person that no determination of profits could be made this year 1943 until after this renegotiation had been completed. Father testified that his attorney, the writer of this brief, advised him not to collect any profits from Son until they could be definitely ascertained—as long as Son left the profits, whatever they were, in the business. Son did this. (Tr. p. 189.) The profits for the year 1944 were ascertained in March, 1945. Why were not the profits of 1944 determined and the one-half of Son's share not paid to the Father? The answer to this is equally conclusive. In the early Spring of 1945 (see McCubbin's Internal Revenue Agent, testimony, Tr. p. 200), the Government sent McCubbin to investigate the validity of the partnership between Father and Son. McCubbin, right from the start, took the position that this partnership was illegal; was void in so far as the Government was concerned; and he reported, as a result of his investiga-

tion, that all of the tax for the preceding years of 1943, 1944, and 1945 should be charged against the Father as an individual; that Son should be allowed a salary during these years of not to exceed $5000.00. The report was made to the respondent Commissioner; hearings were had during the year 1945 and right on up through 1946 and 1947 before him and his staff. As late as August 29, 1946, Miss Wilkinson, Conferee (Exhibit 28, Tr. p. 183) wrote a letter to Son, wherein she stated the Government would recognize the partnership provided that he, Son, would concede that his interest therein was obtained by gift rather than by sale. Father and Son refused to do this. They knew in their own hearts that their partnership was legally formed, in good faith, and this outrageous gestapo maneuver on the part of the Government to force this compromise upon these taxpayers was properly repudiated by them. The writers of this brief desire now to voice an objection not only as counsel for petitioner, but as taxpayers themselves, to this attitude on the part of the Government to concede something which has already been proven, in return for a forced compromise of the taxpayer's rights. The Government, with its unlimited powers and resources, can thus force citizens into unjustifiable positions. It was not until June 5, 1947, that the Commissioner definitely recognized the existence of the partnership. Son's share of the 1945 and 1946 earnings were paid to Father. This procedure was initiated in August, 1947. In other words, the 1945 and 1946 earnings were paid, and we can say to this Court that all other earnings during the

existence of this partnership have been paid to the Father. Cancelled checks were received and entered in evidence. (Exhibits 25 and 27, Tr. p. 81.) It is immaterial whether the payments were endorsed upon the note, as long as they were actually paid. No question was raised concerning the truth of this testimony—in fact, it could not be, because these payments were traced by the Government directly to the bank accounts of Father and then to see whether or not the moneys had been returned to Son. Now, we submit that the reason for the non-payment of the 1943 and 1944 payments of the Son's share of the earnings is reasonably accounted for. In addition thereto, Father testified (Tr. pp. 188 and 189) that the partnership was short of working capital and it was highly advantageous, in view of the large profits made during those two years, that the funds be kept intact in the business as much as possible, and they were so kept.

(13) Respondent's counsel alluded to a "gift" payment which is endorsed upon the note as of December 25, 1943, in the amount of $3000.00. What of it? Father and Mother had a right to make gifts to their children as they saw fit, and if they elected to make them gifts of $3000.00, what better place for the making thereof was there than an endorsement upon this note? If this transfer of interest had been a gift, then we can readily perceive why the $3000.00 should have been given to Son in the form of cash and not as an endorsement upon the note which caused a reduction on the principal amount thereof. This fact, that this reduction was given to the Son to equalize a gift made

to the daughter, is, in our opinion, proof irrefutable that the transaction between Father and Son was one of sale. The same reason applies to the other "gifts" so endorsed upon this note. If this note evidenced a gift, why endorse another gift upon it?

(14) And now we come to that which respondent's counsel, in his brief, viewed with great horror. The endorsement upon the note by counsel for Father and Son of an item of $29,259.00. Counsel for respondent would have it appear that this endorsement had been made by counsel without any authorization from either Father or Son. This is not the truth. Son testified (Tr. pp. 78, 132 and 134) that the endorsement was made by counsel in the presence of himself and his Father and, as he recalled, in their office. Father testified that the endorsement was made with his consent and his authority, but he had forgotten whether the note was in his own or his attorney's possession. (Tr. p. 147.) He did, however, state that this note was continuously in his possession after it was executed and delivered except for the purpose of this endorsement. (Tr. p. 197.) Now, the explanation that counsel for respondent given of how this figure of $29,259.00 was arrived at is correct, but where did he get it? He received it from the parties involved. He received it outside of Court when he asked the writers of this brief to explain the make-up of this item. This was the last case on the calendar—the Court had announced that it wanted to adjourn by three o'clock; we were all rushed—a certain time limit was given to each of us within which to present our case. Regarding matters

which were purely mathematical, we did not deem it necessary to take the time of the Court. It is true that respondent's counsel asked Father many times about an alleged endorsement of $12,000.00. Counsel objected to this question upon the ground that it assumed a fact not in evidence. He was overruled and Father stated he knew nothing whatsoever about an endorsement of this figure. The items figured upon the Bill of Sale amounted to $161,671.96. There was a discrepancy of $20,189.96 because of the corrected figures for items "E" and "F" which had been readjusted in negotiation. This left a total of $141,482.00, one-half of which was $70,741.00, which was the amount that Son should pay for the one-half interest in Father's business. The note was in the sum of $100,000.00. Therefore, the credit which should be placed thereon in order to equalize the same was $29,259.00, which was done, and which facts in explanation thereof, let us again repeat, were given to respondent's counsel outside the Court, at his request. There is no mystery or secret about it.

(15) Respondent's counsel makes much of the fact that Son retained Counsel Smallpage and Scott to represent him in this appearance, thereby eliminating the Government's opportunity to call them as hostile witnesses. In the first place, it is quite natural that Father and Son should retain the counsellor at law who had represented them for years. Second, the argument of respondent's counsel that we could not have been called as witnesses by him is a ridiculous statement of evidentiary law. He could have called

us as witnesses—in so far as Mr. Scott was concerned, there is no law that would make a conversation between him and Father and Son privileged communications; in so far as Smallpage as counsel is concerned, it would have been optional with Son to assert his right of privilege. Mr. Scott, C.P.A. for Son, was present in Court at the request of the respondent, but was not called as a witness. (Tr. p. 223.) It is the old scheme of drawing the red herring across the trail, and in this particular matter it seems to have worked with the Tax Court, because the latter did not pass upon the questions which we respectfully asked this Court to consider. Both counsel at law and in tax have appeared in other matters before Tax Courts, but never, in our experience, have we seen the power of the Government so asserted against clients as was done in this case. The Government demanded some 50 voluminous exhibits of this counsel, who lives 75 miles away from San Francisco, only a very few of which were material. None of these exhibits were incorporated in the transcript in this proceeding. Petitioner has four. These demands for exhibits continued right up to the date of and during the hearing of this matter. We were kept in constant attendance at the Court. This was the last case heard. Father Goold, repeatedly throughout his testimony, stated that he had no idea of making a gift to his Son. Respondent's counsel, in an effort to repudiate him, attempted to lay the ground for the impeachment of his testimony. We quote from the transcript, pages 180, 181 and 182:

Q. And now, at the time that you received this note and had your son sign it, did you ever expect to receive any payments from him on it?

A. I certainly did.

Q. Full payment?

A. Yes, sir.

Q. After adjustments were made for any errors?

A. That is right.

Q. And valuation of certain items included on the Bill of Sale?

A. At the time this note was prepared it was my expectation that he would pay the note in accordance with the terms of the note.

Q. Yet you never insisted that any of the profits be devoted to it, even after the income matter was cleared up?

Mr. Smallpage. Objected to, stating a fact not in evidence. The income tax matter was not straightened up.

The Court. That part of the question will go out. The answer is that he never insisted on his son paying any part of the note.

Q. (by Mr. Marcussen). Now, do you ever recall talking to Mr. McCubbin about this case, who was an Internal Revenue Agent who came out to see you?

A. Some slight conversation. Mr. McCubbin spent considerable time in our office.

Q. Do you ever recall that he questioned you about the amount of the costs of the interest included on the Bill of Sale, and their fair market value, and do you ever recall telling him that you never expected to be paid anything on that note?

Mr. Smallpage. One minute. To which we object on the ground the proper foundation has not been laid, the time, place and people present, and the conversation at least substantially given.

The Court. Objection overruled.

Do you recall that?

Q. (by Mr. Marcussen). On your oath?

The Court. Do you recall saying that?

A. The answer is "no," I don't recall.

The Court. The answer is "no."

Q. (by Mr. Marcussen). Do you recall stating to Mr. McCubbin that this matter had been in the hands of your attorney, and that he had prepared the matter, and that you knew nothing about income taxes, and that, in answer to his questions, you didn't want to fall into any trap?

A. I don't recall any such conversation about falling into any trap, no, sir.

Q. You don't recall?

A. No, sir.

Obviously, the grounds for this alleged impeachment was not laid in accordance with any recognized rules of evidence.

(16) Again, let us look at the answer which the Court put into the mouth of Father Goold. It was "erroneous" to say the least. Even though Father Goold repeatedly stated he had no intention to make a gift, the Court said, referring to Father Goold: "The answer is that he never insisted on his son paying any part of the note." (Tr. p. 181.) Father Goold never made such a statement. It is a positive misstatement of fact. Son did pay to Father in 1947 his

moneys due from 1945 and 1946 operations, and left in the business all of his profits for 1943 and 1944, with the consent of Father.

(17) Again, the respondent, in a desperate effort to impeach Father Goold, called Bruce McCubbin as its witness, the Internal Revenue Agent who, in the early part of 1945, as has been heretofore stated, made an examination of their income tax return for 1943. He was put on the stand, undoubtedly with the expectation that he would testify that Father Goold had told him that he intended to make a gift of this interest in his business, or that he never intended Son to pay upon the note. We quote from the testimony of McCubbin, transcript page 199 to and including page 207:

> BRUCE MCCUBBIN
>
> called as a witness for and on behalf of the respondent, having been first duly sworn, was examined and testified as follows:
>
> Direct Examination
>
> The Clerk. State your name and address.
>
> The Court. Your name is McCubbin, you are an Internal Revenue Agent, is that correct, in the Stockton District?
>
> The Witness. Yes.
>
> The Court. Go ahead.
>
> Q. (By Mr. Marcussen). In the course of the exercise of your duties, did you have occasion to investigate the income tax liability of Mr. Rolly Goold?
>
> A. I did.

Q. And in the course of that investigation, did you have talks with him about his liability from time to time?

A. I did.

Q. And when did you first undertake this investigation?

A. As I remember, the investigation of the various joint ventures in which he was interested in was commenced about either January or February, 1945, very early in the year.

Q. And is that the time that you began also to investigate Rolly Goold's income tax liability for the year 1943?

A. That is right.

Q. And do you recall approximately when it was in the course of your investigation that you had a conference with, or a conversation with Mr. Rolly Goold?

A. I had various conversations with Mr. Goold from the first day I commenced the investigation until the investigation was finally completed.

Q. Did you have any conversation with him about the items on Exhibit 1, which is the Bill of Sale?

Mr. Smallpage. To which we object upon the ground that the question is leading.

The Court. Ask him whether he had any conversations.

Q. (By Mr. Marcussen). Did you?

The Court. Did you have any conversations?

A. I did.

Q. (By Mr. Marcussen). I hand you Exhibit 1-A, and ask you whether those are the items you had a conversation with him about.

Mr. Smallpage. To which we object upon the ground that is leading.

The Court. Sustained.

Mr. Smallpage. And I ask that the document be taken from the witness' inspection.

Mr. Marcussen. I don't see why he can't see an exhibit that has been offered in evidence. I am merely identifying the conversation, that is all.

The Court. Now, Mr. McCubbin, state whether or not you and Rolly Goold ever had a conversation with regard to the exhibit which is before you.

The Witness. We did.

Mr. Marcussen. Yes.

The Court. Now, what was that conversation?

Mr. Smallpage. To which we object upon the ground the proper foundation has not been laid, the time, place, the people present.

The Court. I will withdraw the question because it is improper for me to participate.

Mr. Marcussen. I will restate the question.

Q. (By Mr. Marcussen). Will you state what conversation you had with him about those items, please?

Mr. Smallpage. To which we object upon the ground the proper foundation has not been laid, two grounds, first, the people present, time and place, and for the further ground that this question is obviously for the purpose of discrediting Mr. Rolly Goold.

The Court. Objection overruled. You may answer, Mr. McCubbin.

A. As I remember, I asked Mr. Goold how these items were arrived at, and how their values were determined. To my best recollection, he

stated that at that time they were estimated, they were the closest figures obtainable at that time.

Does that answer the question?

Q. (By Mr. Marcussen). Did you have any conversation with Mr. Goold at all about the note that his son had given him to pay for those items?

A. I did.

Q. What conversation did you have with him about that?

Mr. Smallpage. May it be understood that my objection as to the time, place and people present is interposed to that question?

The Court. The same ruling. Go ahead.

A. I asked Mr. Goold if his son had ever made any payments on account of this note. He stated, "no," he had not, he didn't expect him to make any payments on the note.

Mr. Marcussen. Will you speak up a little bit?

The Witness. I asked Mr. Goold if his son had ever made any payments on this note, Mr. Goold stated, "no," he had not, that he didn't expect his son to make any direct payments because the note provided for payments of 25 per cent of the anticipated profits in these various joint ventures which would be applied against the note.

Mr. Smallpage. Would you give me your reporter's notation where that answer came, please?

The Reporter. Page 50.

Q. (By Mr. Marcussen). Did he say anything else?

A. I asked him—I don't remember exactly the questions that I asked him, but I do know that Mr. Goold——

Mr. Smallpage (interposing). Just a minute! To which we object upon the statement of the

witness that he doesn't remember the questions, that he——

The Court (interposing). Objection overruled. State what you know, Mr. McCubbin.

The Witness. I do know that——

Mr. Smallpage (interposing). May I take an exception to that, please?

The Court. Exception noted.

The Witness. I do know that Mr. Goold made the same statement to me that he has made here, that he couldn't rely on all the figures, and the records were there, he let the records speak for themselves, and he hesitated to answer a direct question in a definite manner for the reason that he was not familiar with income tax law and procedure, and he might get himself in a trap as far as his tax liability was concerned.

The Court. With regard to the last part of that answer, how is it material, Mr. Marcussen?

Mr. Marcussen. The materiality, if your Honor please, is that it shows that the petitioner is relying completely on counsel, it shows a knowledge on his part, that something is attempted to be done here, and he doesn't want to be led into any traps. Now, I think a statement of that kind is exceedingly material.

The Court. Go ahead. Any other questions?

Q. (By Mr. Marcussen). Now, did he say anything further about payments on the note, that you can recall?

A. I don't remember any further statements made by him, or any other questions asked by me in regard to this matter.

Mr. Smallpage. May I see the report, please?

Mr. Marcussen. No, I am not going to put it all in.

Mr. Smallpage. Well, you will put——

Mr. Marcussen. Well, let's not argue about it. Will you please read it?

Mr. Smallpage (examining document).

Mr. Marcussen. Excuse me, your Honor, for raising my voice.

Q. (By Mr. Marcussen). Now, I call your attention here to two paragraphs in this report, which is a report of a technical advisor, the paragraphs being on pages 6 and 7, and ask you just to read that over, this first paragraph.

The Court. Is this shown to the witness to refresh his memory?

Mr. Marcussen. Yes, your Honor.

Mr. Smallpage. And it is being shown to impeach his own witness.

The Court. Go ahead, Mr. McCubbin.

Mr. Marcussen. Just read it, don't read it out loud, just read it, this first part of the first paragraph on page 6.

Q. (By Mr. Marcussen). Now, does that refresh your recollection about anything that Mr. Goold told you about the prospects of payment on that note?

Mr. Smallpage. To which we except.

The Court. All right, state your objection.

Mr. Smallpage. To which we object upon the ground that the document shown to the witness is a typewritten document, it doesn't purport to be signed by the witness, is an obvious attempt to impeach the witness without the proper foundation being laid.

The Court. Objection overruled.

This document was given to you, Mr. McCubbin, for the purpose of refreshing your recollection. You are asked now to testify not to what this

document says, but upon the recollection that you have yourself independently of this document, which it refreshes in your mind, if it does.

Mr. Marcussen. That is correct.

The Court. Now, do you have such a recollection refreshed by this document?

Mr. Smallpage. May I examine the document, your Honor, to ascertain whether or not this witness signed that document, or prepared it, or was it prepared by somebody else?

Mr. Marcussen. I will identify the document further, if you wish.

The Court. Counsel can examine it, yes, I should think.

Mr. Smallpage. In other words, if I understand the law correctly—if not your Honor will correct me—I believe that a witness can only look at such document as he himself prepared for the purpose of refreshing his recollection, or one that was prepared under his direction. I asked counsel to let me look at the rest of the report——

Mr. Marcussen (interposing). I will withdraw the question at this time, if your Honor please.

The Court. The question is withdrawn.

Mr. Marcussen. And ask leave to terminate the examination of the witness at this time, and to put on another witness that will identify this document.

The Court. Well, do you want to continue with the direct examination of this witness on other matters?

Mr. Marcussen. No, your Honor.

The Court. Are you through with him?

Mr. Marcussen. I am through with him.

The Court. Cross-examine.

Mr. Smallpage. No questions.

Mr. Marcussen. All right. Step down.
The Court. That is all, Mr. McCubbin.
(Witness excused.)

And particularly we call this Court's attention to McCubbin's admission (Tr. p. 203):

"The Witness (McCubbin). I asked Mr. Goold if his son had ever made any payments on this note, Mr. Goold stated, "no", he had not, that he didn't expect his son to make any direct payments because the note provided for payments of 25 per cent of the anticipated profits in these various joint ventures which would be applied against the note."

(18) And at transcript pages 203 and 204:

"The Witness (McCubbin). I do know that Mr. Goold made the same statement to me that he has made here, that he couldn't rely on all the figures, and the records were there, he let the records speak for themselves, and he hesitated to answer a direct question in a definite manner for the reason that he was not familiar with income tax law and procedure, and he might get himself in a trap as far as his tax liability was concerned."

(19) Respondent's counsel, evidently disappointed in McCubbin's testimony, called Conferee Agent Mr. Wilker. We quote from the transcript, pages 207 to 223:

WILLIAM G. WILKER

called as a witness for and on behalf of the Respondent, having been first duly sworn, was examined and testified as follows:

Direct Examination

The Clerk. State your name and address.

The Witness. William G. Wilker.

Q. (by Mr. Marcussen). What is your occupation, Mr. Wilker?

A. Conferee of the Technical Staff.

Q. Of the Bureau of Internal Revenue?

A. Of the Bureau of Internal Revenue.

Q. And will you state briefly what are your duties as a Conferee on the Technical Staff?

A. We invite taxpayers to conferences for the purpose of discussing the matters in the case, and arranging a settlement, if possible.

Q. Do you also prepare reports in the course of your duties?

A. Yes, as a consequence we prepare a report of what we have done.

Q. Yes. Do you recall preparing a report in connection with the liability of the Petitioners in this case for the year 1943?

A. I do.

Q. I hand you this file in which is contained——

Mr. Smallpage (interposing). To which we object upon the grounds of immateriality. If counsel desires to introduce it through the witness, that is proper, but a report cannot be introduced in evidence as such.

Mr. Marcussen. I am not offering this in evidence, I don't propose to.

The Court. Well, I am at a loss to know what the question is leading to, then, Mr. Marcussen, the identification of a document which is not to be introduced in evidence.

Mr. Marcussen. If your Honor please, this is the same document which I handed to the preced-

ing witness, and the document is a document which was made by Mr. Wilker. This document contains a quotation from a document prepared by Mr. McCubbin, and I am simply going to identify it by this witness, that quotation, and then I am going to take it to Mr. McCubbin and ask him whether he recognizes it, have it further identified, and then present it to Mr. McCubbin and ask him whether it refreshes his recollection about a conversation he had, not with the taxpayer, but with the taxpayer's father, Mr. Rolly Goold.

The Court. Well, you are proving by this witness, then, that a quotation in the document is a quotation from some matter prepared by Mr. McCubbin himself?

Mr. Marcussen. Yes.

The Court. I see. All right, proceed.

Mr. Smallpage. To which we object upon the ground that that calls for a conclusion of the witness, and the original document is the document that should be produced. The petitioner here is placed in a most disadvantageous position when a government witness is permitted to say, who did not have the talk with the taxpayer, that a document which he holds in his hands is a copy of another document. Until they can show the loss of that other document they are not entitled to show a copy of it, that is fundamental law.

The Court. Objection overruled.

Mr. Marcussen. Very well.

The Court. You may answer, Mr. Wilker.

Mr. Smallpage. Exception, please.

The Court. Exception noted.

Mr. Smallpage. And in order that my objection might be made specific, it is because the proper foundation has not been laid in that it has

not been shown that the document from which the alleged quotation was taken is missing and cannot be produced for examination.

The Court. Go ahead.

Q. (by Mr. Marcussen). Now I call your attention to one of the documents contained in this file, and ask you whether the one referred to is a report prepared by you in connection with the liability of this taxpayer for the year 1943?

A. (examining document). It is.

Q. Is that your signature appearing on page 16 of the report?

A. Yes, sir.

Mr. Smallpage. To which we object upon the ground it is immaterial, what his report is concerning the liability of this taxpayer.

The Court. Overruled.

Mr. Smallpage. It is understood, I also assume, that in a conference held with the representative of the government, that the statements made there which involve compromises and cross questions are certainly not to be used against the witness, unless he himself had a transcription in shorthand, or it was by some other recognized means taken down.

The Court. Go ahead.

Mr. Marcussen. Now, if your Honor please——

The Court (interposing). Let's get the point of this.

Mr. Marcussen. I must make a statement to clarify the record at this point, if your Honor will indulge me.

The Court. I don't think the record needs clarification, because I think the record is clear. The purpose of this is merely to identify as a copy, from something that Mr. McCubbin wrote, two

paragraphs in this document which is before this witness.

Mr. Marcussen. Yes. I also wish the record to show, your Honor, that this is not a statement made by the taxpayer in any attempt to compromise his liability at all.

The Court. All right, go ahead. As I said before, the record doesn't need it because——

Mr. Smallpage (interposing). Well then, the objection is it is hearsay.

The Court. Go ahead.

Q. (by Mr. Marcussen). I call your attention to page 6 of this document, and I call your attention to the paragraph beginning slightly below the middle of the page, which reads——

Mr. Smallpage (interposing). Just a minute. Let him read it himself.

Q. (by Mr. Marcussen). I will ask you to read it.

A. "The above mentioned——"

Q. (interposing). No.

The Court. No.

A. "——Revenue Agent's report——"

Q. (by Mr. Marcussen) (interposing). Just read it silently, Mr. Wilker.

A. Oh, excuse me. I am sorry, I am sorry.

Q. Have you read it?

A. Yes.

Mr. Marcussen. Do you want to see it, counsel?

Mr. Smallpage. Yes, certainly, I want to see the whole document.

Q. (by Mr. Marcussen). I ask you to state——

Mr. Smallpage (interposing). Just a minute! Let me read the whole document.

Mr. Marcussen. No, the document is not in evidence. The document consists of sixteen pages. It is a confidential document. I am merely establishing a quotation from a particular page, your Honor.

Mr. Smallpage. It would seem to me, your Honor, that if any portion of this document can be shown to the witness it should be shown to the counsel for the Petitioner.

The Court. Go ahead. The only purpose of this, as I see it, is to get two paragraphs identified as from a letter, or a statement, or a document prepared by Mr. McCubbin. That is the only relevancy of this at all.

Mr. Smallpage. Alleged to have been prepared.

The Court. Well, that is all right, alleged to have been. I don't know. Let the witness testify. The rest of the document is irrelevant and immaterial, we are not interested in it.

I don't take it that counsel for the government is interested in it.

Mr. Marcussen. That is right.

The Court. The rest of the document would be totally irrelevant and immaterial, because, as you pointed out, the proceedings before the Conferee, before any settlement proceedings, are as though they were nothing in the proceeding here. We are not interested in any statements made or in any action taken by way of settlement.

Mr. Smallpage. All right. Then is this not fair, your Honor, that before they produce a copy made by a third person, why don't they produce the report itself? It must be in the files of the government. I don't think that is an unfair request. Why don't they produce Mr. McCubbin's own report? I have no objection to that.

The Court. Let's go ahead. The point of argument here is with regard to this witness' examination as to those paragraphs.

Now proceed, Mr. Marcussen.

Q. (by Mr. Marcussen). Now I would like to ask you, Mr. Wilker, about these two paragraphs which are in quotation marks, and ask you where you got those two paragraphs that are quoted on pages 6 and 7 of this report.

A. From a report by the Revenue Agent.

Q. And who was the Revenue Agent?

A. Mr. McCubbin.

Q. Yes. And at the time that you inserted these two paragraphs from that Revenue Agent's report in this report, did you have the Revenue Agent's report before you?

A. I did.

Q. And it was taken from that?

A. Yes.

Q. Do you know where that report is now?

A. No.

Mr. Marcussen. That is all that I have to ask of this witness.

The Court. That is all, unless there is cross examination.

Mr. Smallpage. Yes, I would like to know what became——

The Court (interposing). All right.

Cross-Examination

by Mr. Smallpage.

Q. Mr. Witness, how voluminous was that report of Mr. McCubbin's from which he took this extract?

A. Oh, I don't recall.

Q. Well, was it four pages or ten pages?

A. Oh, more likely ten, but I am not certain.

Q. It was a bound volume, or a bound report, was it not?

A. Well, no, not bound, that is, it was a sheaf of papers fastened together, I presume, with a staple or fastener.

Q. It is a part of the government records, in so far as this transaction is concerned?

A. It was when I had it.

Q. And you treated it as such, did you not?

A. Oh, yes.

Q. Now, what did you do with it?

A. I associated it with the file when I transmitted the file to my superiors.

Q. That is to say, it was filed with this document of which this is alleged to be a copy, is that right?

A. Pardon me?

Q. It was filed with, or associated with you—by the way, what do you mean by the word "associated" by you?

A. Put into the files, placed with the docket, or with the folder that I had for the case.

Q. And was it stapled at the time?

A. No.

Q. But it was at least put in there in the same way your report was?

A. Well, it was kept separate, my report was, upon the petitioner, the partnership report was a separate document, kept separate from that file, that is, it was not bound in a jacket like this.

Q. All right, but you put it in the jacket when you returned it?

A. Oh, yes; oh yes.

Q. To whom did you return it?

A. It went to my superior.

Q. Who is that?

A. Mr. Lowder and Mr. Harlacher, from there it would go to the file clerks.

Q. Have you made any search to ascertain whether or not that document is not in the files at the present time?

A. No.

Q. Has anyone ever requested of you that you make a search to ascertain?

A. No.

Q. Now, in the preparation of your report, did you dictate that particular paragraph, or did you give Mr. McCubbin's alleged report to a stenographer and tell her to make a transcription?

A. I told her to make a transcription and checked it.

Q. And is that the only portion of his report that is included?

Mr. Marcussen. Object to that, it has no materiality, if your Honor please.

Q. (by Mr. Smallpage). That is included in this document?

A. As a quotation?

Mr. Marcussen. Objection on the ground it is immaterial, your Honor, and going to take time.

The Witness. It is the only part I see quoted.

The Court. All right, any other questions.

Mr. Smallpage. That is all.

The Court. That is all.

Mr. Marcussen. Now, just a moment, Mr. Wilker.

Redirect Examination
by Mr. Marcussen.

Q. You testified that the Revenue Agent's report was returned to the file. Is that the same as this file that is involved in this proceeding?

A. When I said to the files, I meant to our file room in our office room. From there I can imagine that it was returned to the Revenue Agent's office.

Q. I see.

And I think you testified that that was a report of the partnership, the analysis of the partnership income?

A. Yes, yes, this was on the partnership.

Q. Well, in the ordinary course of Bureau procedure, would that document be placed in this file, or would it be returned to the partnership file?

A. It was returned to the partnership file.

Q. Yes. And do you recall whether I asked you to look for that in this file? Have you made a search?

A. Yes, I have looked in this file.

Q. And did you find it?

A. No.

Mr. Marcussen. That is all.

The Court. That is all, sir.

Mr. Smallpage. Just one minute.

Recross Examination
by Mr. Smallpage.

Q. Mr. Witness, at the time that Mr. Scott and Mr. Goold and his son and myself were in your office, did you at that time have Mr. McCubbin's report before you?

Mr. Marcussen. Object to it on the grounds it is immaterial. We are not concerned about any conferences that took place.

The Court. I don't think it is material.

Mr. Marcussen. In the Technical Staff, that is the whole point.

The Court. I will sustain the objection.

Q. (by Mr. Smallpage). Did you at the time that we had that conference make any statement to us individually or collectively that Mr. Goold had made any statement to Mr. McCubbin with respect to the terms under which he had sold this property to his son?

Mr. Marcussen. Objection on the grounds that it is not proper cross-examination, not within the scope of the direct.

The Court. I will sustain the objection.

Mr. Smallpage. That is all.

The Court. That is all, sir.

(Witness excused.)

Mr. Marcussen. Recall Mr. McCubbin, please.

Whereupon,

BRUCE McCUBBIN,

recalled as a witness for and on behalf of the Respondent, having been previously sworn, was examined and testified further as follows:

Direct Examination
by Mr. Marcussen.

Q. Now, Mr. McCubbin, I want to call your attention to page 6 of this report which has been identified by the preceding witness, and I call your attention to the second last paragraph on the page which appears in quotation marks, and

is the first of the two paragraphs which the preceding witness identified, and I ask you——

The Court (interposing). You might just ask him whether that refreshes his recollection or not.

Q. (by Mr. Marcussen). Yes, whether that refreshes your recollection as to any conversation that you had with Rolly Goold as to the subject of making payments on the note?

Mr. Smallpage. Just a minute, if your Honor please.

The Court. All right.

Mr. Smallpage. That document should never have been shown to this witness until I have had an opportunity to object to it. It is an attempt to impeach his own witness without the proper foundation being laid. The phraseology contained in these two paragraphs is at distinct variance with what the witness testified to on direct examination. Now, it is most assuredly unfair to this witness to be presented with a document which he himself does not know is a quotation from a report which was made by him, and in view of the fact that the government has shown no attempt, no effort whatsoever to go over to their file room and get the other document which certainly must be in existence, the original report from which that document that extract was taken is in existence, it is right here. We have produced for the government some, I think, 50 exhibits. We only had three or four. They required and asked us repeatedly up to Saturday to produce different exhibits. Now, certainly they have had the opportunity to go over there and bring that partnership report here, and if they wanted to refresh

Mr. McCubbin's mind, they could have had it here to do so, and to rely upon an alleged copy made by a stenographer who was told to copy a paragraph is most unfair to the witness, and does not constitute the proper foundation for an impeachment of their own witness. That is exactly what this is.

The Court. Objection overruled.

Does this refresh your recollection?

The Witness. It does.

Q. (by Mr. Marcussen). Now, can you testify after your recollection is refreshed as to what Mr. Rolly Goold did tell you about payments on the note?

Mr. Smallpage. Just a minute! To which we object upon the ground that the question has been asked and answered in direct conversation.

The Court. Overruled.

A. Well, he stated he had received——

The Court (interposing). Now you are testifying from your own recollection?

Mr. Smallpage. Listen, let's remove the document from the witness'——

The Court (interposing). You are not testifying from any document, it is just what you remember now from your own recollection of it.

Mr. Smallpage. Let's put it up here.

Mr. Marcussen. Let's leave it here. I have covered the page.

The Witness. As I remember, Mr. Goold stated that he had received no payments on the note, and he didn't expect to receive any direct payments on the note. As I recollect, Mr. Goold stated that he at that time had received no payments on the note, and did not expect to receive any payments on the note.

Q. (by Mr. Marcussen). Now, is there any doubt about it in your mind at all, as to whether he made that statement to you?

A. No, there never was.

Mr. Marcussen. That is all.

Mr. Smallpage. Will you please refer back to the witness' testimony that he gave on direct ex-examination, wherein he stated that Mr. Goold did not expect his son to make payments on the note, but his money on the note was to come out of his son's share of the profits of the business? Please refer to that testimony that the witness gave.

The Court. Was that the part that you asked the reporter to make a notation on?

Mr. Smallpage. It is right about in there, if your Honor recalls that testimony.

The Court. Well, the testimony will appear when the transcript is made up. You may cross-examine the witness on the assumption that he did make the statement.

Mr. Smallpage. Thank you. I did not want to make cross-examination on an erroneous assumption of fact.

The Court. All right.

Mr. Marcussen. Now, will it be understood that you will state to the witness what you understood his statement was?

Mr. Smallpage. Please refer back to your notes, page 50.

The Court. I don't know if the reporter can find it. Do you think you can?

(The testimony referred to was read by the reporter, as follows:)

"Answer. I asked Mr. Goold if his son had ever made any payments on account of this

note. He stated, 'no,' he had not, he did not expect him to make any payments on the note."

The Court. All right, that is enough. Your assumption is correct.

Mr. Smallpage. I thought it was.

Cross-Examination

Q. (by Mr. Smallpage). Now, that is a fact what he said, isn't it, Mr. McCubbin, your testimony is true and correct as given in your direct examination and as reported by this young lady?

A. That is correct, but I still believe that both of my statements——

Q. (interposing). Just a minute!

The Court. Not what you believe, what he said. Now, you said once that he said he didn't expect any direct payments because he was going to get payment out of the profits.

The Witness. That is right.

The Court. All right, it is not what you believe, it is what he said.

The Witness. All right.

Q. (by Mr. Smallpage). Now, Mr. McCubbin, in your report you never made any contention that this transaction between Goold and his son was a gift and not a purchase, did you?

Mr. Marcussen. Object to that on the grounds it is improper cross-examination.

The Court. Sustained.

Mr. Smallpage. All right, I call for the report.

The Court. All right, it does not make any difference what Mr. McCubbin contended with regard to it, we are interested in what the facts are.

Mr. Smallpage. That is right. All right.

> The Court. Yes, it is irrelevant.
>
> Mr. Smallpage. The point I want to make is this: That is if he had received any evidence to the effect that this was a gift and not a purchase transaction, he should have so reported it in his return, which he did not, and I submit it is a matter of fact that he made no such return. I am not privileged, as I understand the law, to examine these Internal Revenue Agents' reports. That is correct, is it not, your Honor?

Boiled down, respondent's counsel had Conferee Wilker identify a report made by the latter in this matter, presumably as a result of a conference between Son and himself, in which he included an alleged two paragraphs of a different report claimed to have been made by McCubbin in this matter. Wilker admitted, upon cross-examination, that he gave the McCubbin report to a stenographer to copy the two paragraphs in question, into his report, which was then before the Court. Now, we respectfully call the attention of this Court to this extraordinary procedure which took place in a United States Court: The Wilker report was shown to him (Wilker). Counsel for Son asked permission to look at the report. This permission was denied by the Tax Court upon the objection of respondent's counsel that it was privileged. Counsel for Son was not allowed even to examine these so-called two paragraphs which Wilker identified. Thereafter, McCubbin was put on the stand and asked to look at these same two paragraphs, and from reading them, to refresh his recollection of what Father Goold had stated. McCubbin still, how-

ever, testified in accordance with his previous statement. Counsel for Goold demanded the production of the McCubbin report, of which these two paragraphs had been presented to the witness. We were denied this right, even though it is obvious, from the aforesaid testimony, that the McCubbin report was in the files of either respondent's counsel or in the government itself. Since respondent's counsel arbitrarily refused to produce this report, it is a reasonable deduction, and it is the rule of evidence that we must assume that the report contained matters favorable to the contention of Son.

(20) It is the duty of the Courts to protect the government against the illegal claims of its citizens, but it is equally an important function of this Court to protect its citizens against the unreasonable, unlawful usurpation of power by those entrusted therewith.

(21) Again we call the attention of the Court to the questionable tactics used in this case. We quote from Transcript, pages 177 to 187:

> Q. Now, I think the evidence that has been introduced here will show that your son even for the year 1943 had a share in the profits of $60,000, and the evidence will also show substantial earnings for the succeeding years, '44, '45, '46 and '47, and I ask you whether you have any explanation as to why, since the conclusion now of all these income tax matters relative to the recognition of the partnership, why wasn't his share of the earnings endorsed on that, and why wasn't

his share devoted to paying his obligation on this note?

A. Frankly, I didn't think there was a conclusion of the Internal Revenue matter. I thought that is what brought us here at the present time.

Q. The partnership is recognized, you understand that, don't you?

A. No, I have no assurance that the partnership is recognized. I understood that the partnership was being attacked in this proceedings.

Q. Well, if you were told that the partnership is not being attacked in these proceedings, and that your attorney knows that, and that he knew it was not being attacked from the beginning, way back in 1945, now, do you have any other explanation that you want to make as to why your son's share of the earnings were not applied in the payment of this note in accordance with the terms of the note?

A. Just a matter of confusion.

Mr. Smallpage. To which we object upon the ground that counsel has made a misstatement of fact, your Honor.

The Court. Objection overruled.

Mr. Smallpage. Well, may we——

The Court (interposing). The objection is overruled. The witness may answer.

Mr. Marcussen. Can you answer?

The Witness. Will you repeat the question, please?

(The pending question was read by the reporter, as follows:

"Question. Well, if you were told that the partnership is not being attacked in these proceedings, and that your attorney knows that, and that he knew it was not being attacked

from the beginning, way back in 1945, now, do you have any other explanation that you want to make as to why your son's share of the earnings were not applied in the payment of this note in accordance with the terms of the note?")

Mr. Smallpage. I respectfully suggest, your Honor, that that is assuming a fact not in evidence. The partnership was continuously under attack until August the 8th, 1946, when it was recognized.

The Court. Objection overruled. He is asked to assume certain facts.

If you assume the facts stated by counsel for the respondent, what is your answer? Have you got any other reason why your son didn't make any payments on these notes?

The Witness. No.

The Court. This note? That is the only reason you have, that there was trouble with the Bureau of Internal Revenue, is that right?

The Witness. That is correct, yes, sir.

Q. (by Mr. Marcussen). Now, was it your purpose in making this purported sale to your son to have him pay merely for one-half the value of these assets transferred?

A. That is the terms of the note, I believe, sir, yes.

Q. Well, I call your attention to the fact that in the Bill of Sale——

A. (interposing). The terms are in the Bill of Sale.

Q. —the total of the assets transferred is $161,000 some odd, and that he signs a note for $100,000.

A. Well, I have no explanation on that as to why that amount was set up at $100,000, except for the fact these items down here were unknown at that particular time.

Q. They turned out actually to be less, but even on the figures that you have got on the Exhibit 1, the total of the assets in which you are conveying to him one-half interest totaled $161,000, and you have him sign a note for $100,000. Do you have any explanation to offer for that?

A. The note was prepared by counsel. Just what the particular reasons for it were I couldn't tell you.

Q. Did counsel determine the amount of the note?

A. No, counsel determined the amount of the note, the amount of the note——

Q. (interposing). Was $100,000. Now, who decided upon that $100,000?

A. I believe that it was counsel who decided to set the note up at $100,000, and make subsequent adjustments if it became necessary as to what the figures should be.

Q. And now, at the time that you received this note and had your son sign it, did you ever expect to receive any payments from him on it?

A. I certainly did.

Q. Full payment?

A. Yes, sir.

Q. After adjustments were made for any errors?

A. That is right.

Q. And valuation of certain items included on the Bill of Sale?

A. At the time this note was prepared it was my expectation that he would pay the note in accordance with the terms of the note.

Q. Yet you never insisted that any of the profits be devoted to it, even after the income matter was cleared up?

Mr. Smallpage. Objected to, stating a fact not in evidence. The income tax matter was not straightened up.

The Court. That part of the question will go out. The answer is that he never insisted on his son paying any part of the note.

Q. (by Mr. Marcussen). Now, do you ever recall talking to Mr. McCubbin about this case, who was an Internal Revenue Agent who came out to see you?

A. Some slight conversation. Mr. McCubbin spent considerable time in our office.

Q. Do you ever recall that he questioned you about the amount of the costs of the interest included on the Bill of Sale, and their fair market value, and do you ever recall telling him that you never expected to be paid anything on that note?

Mr. Smallpage. One minute. To which we object on the ground the proper foundation has not been laid, the time, place and people present, and the conversation at least substantially given.

The Court. Objection overruled.

Do you recall that?

Q. (by Mr. Marcussen). On your oath?

The Court. Do you recall saying that?

A. The answer is "no," I don't recall.

The Court. The answer is "no."

Q. (by Mr. Marcussen). Do you recall stating to Mr. McCubbin that this matter had been in the

hands of your attorney, and that he had prepared the matter, and that you knew nothing about income taxes, and that, in answer to his questions, you didn't want to fall into any trap?

A. I don't recall any such conversation about falling into any trap, no, sir.

Q. You don't recall?

A. No, sir.

Mr. Marcussen. That is all, your Honor.

Mr. Smallpage. Will you stipulate that that is a true and correct copy of the original letter from the Conferee's office respecting this matter, from the Internal Revenue Department?

What time does your train leave, your Honor?

The Court. That is all right, we will go right ahead.

Mr. Smallpage. I have only taken 25 minutes.

The Court. That is all right, don't be alarmed.

Mr. Marcussen (examining document). No objection.

Mr. Smallpage. We offer this in evidence.

The Court. It will be admitted in evidence.

Mr. Smallpage. And ask it be marked next in order. For continuity, I want to say, your Honor, it is a letter of compromise from the Department with respect to recognizing the partnership, providing that we do certain things, and the date of it is August, 1946.

The Clerk. Exhibit 28.

(The letter referred to was marked and received in evidence as Petitioner's Exhibit No. 28.)

Petitioner's Exhibit No. 28

Treasury Department
Internal Revenue Service
San Francisco 5, Calif.
August 20, 1946

Office of
Internal Revenue Agent in Charge
San Francisco Division
74 New Montgomery Street

In Replying Refer to IRA:Conf-ALW

Mr. LaFayette J. Smallpage
Room 511, Savings and Loan Bank Building
Stockton, California

In re: R. Goold and Son
R. Goold
E. R. Goold
Stockton, California

Year: 1943

Dear Mr. Smallpage:

In further reference to the protests filed by you with respect to the above-named taxpayers for the year 1943, the following adjustments are suggested as a basis for settlement. In case you are willing to close the cases on this basis, the result will be subject to approval by the reviewing authorities in this office and in the Bureau.

(a) To recognize the partnership between R. Goold and E. R. Goold.

(b) To consider the transfer of an undivided one-half interest in the partnership assets as a gift to the son instead of a sale as claimed; gift tax to be adjusted and determined later.

(c) To consider that the son's interest in the partnership is his separate property, and that his

distributive share of the partnership profits is taxable in full to him except one-half of a reasonable salary for his services of $5,000.00, or $2,500.00, which amount will be taxed to his wife, as her one-half share of the community income.

(d) Since the deduction of $2,211.00 claimed for Mr. R. Goold's expenses in connection with the Marysville job was incurred over a period of 67 weeks running from March 23, 1942 to September 1943, and since there are no records to verify such expenditures, a deduction will be allowed of $500.00 to cover cost of meals and lodging at Marysville for estimated 35 trips made in 1943 and for automobile expense. Mr. Goold used an automobile which belonged to the electrical appliance business and it is assumed that most of the expenses of this car were included in automobile expenses claimed and allowed to that business.

(e) If the above-stated adjustments are acceptable to the taxpayers, the personal exemption and credit for dependents will be allowed in full to E. R. Goold since this adjustment will be to the mutual tax advantage of E. R. Goold and his wife.

Please advise this office at the earliest available time as to whether the settlement as set forth above is acceptable to the taxpayers in question. Another hearing in this office for further discussion of the issues and the basis of settlement will be granted upon written request.

Very truly yours,
/s/A. L. Wilkinson,
Conferee Revenue Agent.

ALW:eh
cc to Mr. R. Goold and
Mr. E. R. Goold

Mr. Smallpage. It will be considered as read in evidence?

The Court. That is right.

Mr. Smallpage. That is, the significant portion.

The Court. I don't have to get away from here until three o'clock, I just want counsel to know.

Mr. Smallpage. I am hurrying my examination along a little, but I took account of my time. I have exactly 25 minutes.

I ask that this document be marked Petitioner's Exhibit for identification next in number.

The Clerk. Marked for identification only Exhibit 29.

(The document referred to was marked as Petitioner's Exhibit No. 29, for identification.)

Redirect Examination
by Mr. Smallpage.

Q. I present this document to you, which has been taken out of my file, respecting this matter, which is entitled, "Assets conveyed to Everett R. Goold, January 1, 1943, which becomes the assets of partnership R. Goold and Son."

I ask you if that document was given——

Mr. Marcussen (interposing). Object to the question on the grounds it is leading, and ask counsel, if your Honor please, to ask the witness what that document is.

The Court. All right, what is it, Mr. Witness?

Mr. Smallpage. Wait a minute, may I——

The Court. All right, reform you question.

Mr. Smallpage. I just gave the title.

Q. (by Mr. Smallpage). Was that document delivered by you to me?

Mr. Marcussen. Object to that on the ground it is a leading question.

The Court. Objection sustained.

Mr. Smallpage. A leading question to ask him if he gave it to me?

The Court. That is right.

Mr. Smallpage. Do we take exceptions?

The Court. Exception noted. The witness can be asked to describe that letter, or that document, what it is, and what he did with it, if he knows. This is direct examination, redirect examination.

Q. (by Mr. Smallpage). Well, is that document in your handwriting?

A. The document is in my handwriting, yes, sir.

Q. All right. What did you do with it?

A. This was a document that was turned over to you at the time that we were preparing to sell this partnership interest, half of it, to sell this partnership interest on January the 1st, 1943, and in my writing down here I have subscribed "the above is the interest of R. Goold on the above day, and are the assets of the partnership. All of the above is community property of R. Goold and Katharine Goold, his wife."

Q. I call your particular attention to the words, "estimated."

A. Opposite two of the accounts here I have written the words "estimated" because of the fact we weren't able to determine the value at that time.

Mr. Smallpage. We ask that this be admitted in evidence.

The Witness. The books didn't disclose that.

The Court. Admitted.

The Clerk. Exhibit 29.

The assumption adopted by respondent's counsel that the partnership between Father and Son had been recognized by respondent in the year 1945 is a positive misstatement of fact, and we charge now that respondent's counsel personally well knew that it was not until August 5, 1947, that there had been an admission by the Government of the validity of this partnership. Even in his brief, respondent's counsel utilized many pages in attacking this partnership, as though there were something viciously wrong in a Father making his son a partner; a Son who was actively engaged in the operation of the business.

SECOND QUESTION.

Facts.

(A) This Second Question has been raised by the petitioner's fourth assignment of error. It involves solely a narrow question of the interpretation of the provisions of section 451(a)(3), Internal Revenue Code. The statutory provisions in question, which were added to the Internal Revenue Code by section 172(a), Revenue Act of 1942, and repealed by section 6(a), Individual Income Tax Act of 1944, read as follows:

> "Sec. 451(a) Definition.—The term 'Victory tax net income' in the case of any taxable year means * * * the gross income for such year * * * minus the sum of the following deductions:
> * * * * * * *
> "(3) Taxes.—Amounts allowable as a deduction by Section 23(c) to the extent such amounts are

paid or incurred in connection with the carrying on of a trade or business, or in connection with property used in the trade or business, or in connection with property held for the production of income."

(B) In the proceeding below the petitioner argued substantially as he does hereunder for a construction of the said section 451(a)(3) which would include in the deductions to be made in computing "victory tax net income" income taxes on business income levied by the State of California which had been paid or accrued in the period (in this case the calendar year 1943) for which the victory tax was levied. The Tax Court thought that such California income taxes on business income were not included in the terms of the said section 451(a)(3) and upheld the respondent's disallowance of such income taxes as a deduction in computing victory tax net income adhering to its opinion in the earlier case of *Anna Harris et al.*, 8 T. C. 818, a petition to this Court of Appeals for review of which was filed on another issue.

ARGUMENT.

(1) THE CONSTRUCTION OF SECTION 451(a)(3), I. R. C., REQUIRES NO EXTRANEOUS AIDS.

The statutory provisions in question are unambiguous. In such a case the Tax Courts should not have looked beyond the language of the statute itself. As stated in 25 Ruling Case Law 962—

"* * * When the language of the statute is plain and unambiguous and conveys a clear and definite meaning, there is no occasion for resorting to the rules of statutory interpretation and construction; the statute must be given its plain and obvious meaning. This principle is to be adhered to notwithstanding the fact that the court may be convinced by extraneous circumstances that the legislature intended to enact something very different from that which it did enact."

To the same effect, see also *Lake County v. Rollins,* 130 U.S. 662; *United States v. Merriam,* 263 U.S. 179 (T.D. 3535, C. B. II-2, 87); *Penn Mutual Life Insurance Co. v. Lederer,* 252 U.S. 523 (T.D. 3046, C. B. 3, 249); *New York Telephone Co. v. Treat,* 130 Fed. 340, certiorari denied 198 U.S. 584; *Isslin v. United States,* 270 U.S. 245, 70 L. Ed. 566, 46 S. Ct. 248 (1926); *Caminetti v. United States,* 242 U.S. 470, 61 L. Ed. 442, 37 S. Ct. 192 (1917); and *Lewis' Sutherland Statutory Construction,* section 363. Cf. G.C.M. 7285, C. B. IX-1, p. 181, a ruling on behalf of the respondent's predecessor in office, at page 184.

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(2) THE TERMS OF SECTION 451(a)(3) PLAINLY INCLUDE CALIFORNIA INCOME TAXES ON BUSINESS INCOME.

Section 451(a)(3) as copied above makes dual requirements for deductions of taxes (1) that they be allowable under the provisions of section 23(c) and (2) that they be "paid or incurred (a) in connection with the carrying on of a trade or business, or (b) in

connection with property used in a trade or business, or (c) in connection with property held for the production of income".

As to the first requirement, the Tax Court has held in *Mary E. Evans, et al.,* 42 B.T.A. 246 (1940), that California income taxes are deductible under section 23(c).

As to the second requirement, attention is directed first to the broad statement of the requirements which adds to the general statement in Clause (a) "in connection with the carrying on of a trade or business", two alternative clauses (b) "in connection with property used in a trade or business" (apparently to obviate any question of the inclusion of ad valorem, use or similar taxes on property), and (c) "in connection with property held for the production of income" (apparently to permit deductions of taxes levied on property held for rents, dividends or interest whether or not such income is actually received in any particular taxable year). Just as in the case of the other deductions from gross income described in subsection 451(a)(1) to (7), inclusive, the obvious intent of this designedly expansive description of deductible taxes is to bring the allowance within the class of "expenses or other allowable deductions connected with a trade or business, or incurred in connection with the management, conservation or maintenance of property held for the production of income". Compare explanation in Senate Report No. 1631, Seventy-seventh Congress, Second Session, by the Committee on Finance, C. B. 1942-2, pp. 508 and 624.

In the case of this or any other taxpayer residing in California, income from business is subject to a graduated income tax on a basis of constitutional authority and definitions quite similar to the Federal income tax. For text see Chap. 329, California Statutes 1935, as amended. Such a tax is under the rule of *Pollock v. Farmers Loan & Trust Co.,* 157 U.S. 429, 29 L. Ed. 759 (1895) a direct tax. See also *Mertens, Law of Federal Income Taxation,* Sec. 4.07 and 4.08 (V. 1) pages 131-135, and numerous citations in notes. This income from the business of this petitioner was a measure of a definite part of his California income taxes incurred or paid. If a tax so based, caused and measured with reference to business income is not, in the terms of the statute, "incurred in connection with the carrying on of a trade or business", no other tax could possibly be so incurred. Without the business there would be no income from it and no state income tax. The relation of the business to the tax is one of cause and effect. The term "in connection with" used abstractly as in this statute can have no other applicable meaning than "having a causal or ~~lorical~~ logical relationship with". (Cf. Webster's New International Dictionary, Second Edition.)

(3) THE RESPONDENT'S CONSTRUCTION OF SECTION 451(a)(3), I. R. C., TO EXCLUDE DEDUCTIONS OF STATE INCOME TAXES ON BUSINESS INCOME IS FALLACIOUS AND ERRONEOUS.

The respondent has attempted in I. T. 3644, C. B. 1944, p. 372, to construe Sec. 451(a)(3), I. R. C. to exclude state income taxes on individuals from the deductions allowable for the victory tax even to the extent that these taxes may have been levied on business income, rents, dividends, and other income from property. As we have shown above the language of the statute clearly and unequivocally allows the deduction of state income taxes on, or measured by, income from business. In ruling to the contrary, the Commissioner has assumed and appropriated an authority of construction and interpretation contrary to the fundamental rule of statutory construction discussed under proposition (1) above.

The ruling in question is based on an argument (1) that the Congress intended to restrict, for victory tax purposes, the deductions ordinarily allowed by section 23(c) of the Code because (a) the language of section 451(a)(3) expressed a restriction, and (b) because the Committee on Finance of the Senate stated in explanation of the limitation of the tax in section 456 (Senate Report No. 1631, Seventy-seventh Congress, Second Session, C. B. 1942-2, 509), that:

> "*Since the victory tax does not allow any deduction for State income taxes,* your committee deemed it advisable to provide that the total income tax and victory tax should not exceed 90 per cent of the taxpayer's net income * * *." (Italics in I. T. 3644.)

and concluded (2), without further explanation or elucidation, that the intended restriction excluded income taxes on business income, rents, dividends and similar income from property. The *non sequitur* of the conclusion is apparent from this analytical statement of the argument.

The Congress did intend to restrict, for victory tax purposes, the deductions ordinarily allowed by section 23(c) and, as shown in our exegesis in proposition (1) of this argument, stated that restriction in section 451(a)(3) clearly, succinctly and beyond the need of any interpretation based on the congressional report, in terms which clearly allow the deduction of state income taxes on business income. But if aid from the report were needed, the explanation of the deduction provisions in the Senate Report cited at pp. 508 and 624, C. B. 1942-2, is not indicative of any intention whatever to exclude state income taxes.

The statement of the Committee on Finance in explanation of the limitation feature of the victory tax law (Subchapter D of Chapter 1 of the Internal Revenue Code) in section 456 that the limitation was provided because "the victory tax does not allow any deduction for State income taxes" was directed to and explained only the provisions of section 456; it was not even intended to explain the provisions of section 451(a), let alone modify the plainly stated terms of subdivision (3) thereof. It should be compared, too, to the Committee's detailed discussion of section 456 (C. B. 1942-2, p. 626) which makes no reference to state income taxes. The Committee no

doubt had in mind, in considering the limitation provision, that the handful of individuals to which its terms would apply would normally have considerable income from salaries, commissions, annuities, etc. on which the income taxes levied by the States would not be deductible under the provisions of section 451(a)(3), thereby creating a situation in which the combined levies for the Federal income and victory taxes and the personal income taxes of the states at the rates prevailing in some of them (notably New York and California) in 1942 would exceed 100 per cent of the taxable income; hence the limitation of the combined Federal income and victory taxes to 90 per cent to halt the confiscatory effect of the combined Federal and State income taxes. Any such considerations, whatever they may have been in detail, had no bearing on the provisions of section 451(a)(3) even if the general statement italicized in the quotation in I. T. 3644 had been literally in harmony with those provisions, instead of only partly so, i.e., only with respect to income taxes on compensation for services, annuities, etc. As we have noted above, it does not at all follow by any rule or logic or of statutory construction from the Committee's statement with regard to the limitation in section 456 that state income taxes on business income were excluded from the deductions allowed by section 451(a)(3). When the draftsman of I. T. 3644 read into the phrase of the Committee's explanation of section 456 an explanation of, or a narrowing of, the allowances of taxes by section 451(a)(3), he was simply reading something that is not there. The process by which he so read it, whether

by preconception of the meaning of the subparagraph (3) in question, or by some erroneous notion as to the rules of statutory construction, as to which the hiatus between the premises and the conclusion in that ruling leaves us completely uninformed, is of no importance; what is important is that the phrase in question has no relation to the meaning of section 451(a)(3).

The Court below has upheld the respondent's disallowance of the accrued California income tax on business income on the authority of its holding in an earlier case, *Anna Harris, et al.,* 10 T. C. 818 (now pending on a petition for review before this Court of Appeals), involving in part the same issue. It is suggested that in her opinion in the *Harris* case Judge Harron of the Tax Court has fallen into the same fallacies of statutory construction and of interpreting the congressional committee reports as did the draftsman of I. T. 3644, and that her opinion should therefore be overruled.

CONCLUSION.

As to the First Question, we believe that a fair consideration of the evidence in this case will lead this Court to rule that this transaction was not one of gift, but one of sale, and that the petitioner should have judgment.

As to the Second Question, since we have shown that according to the correct rule of statutory construction, proposition (1), section 451(a)(3) of the

Internal Revenue Code includes and permits the deduction of California income tax on business income in computing victory tax net income (proposition (2)), and that the respondent's ruling to the contrary in I. T. 3644 and the opinion of the Court are fallacious and erroneous interpretations of the statute (proposition (3)), it follows that the disallowance of the deduction in question by the respondent and the Tax Court should be disapproved and overruled.

Dated, Stockton, California,
December 28, 1949.

Respectfully submitted,

LAFAYETTE J. SMALLPAGE,
Attorney for Petitioner.

No. 12,296

In the United States Court of Appeals for the Ninth Circuit

E. R. GOOLD, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

ON PETITION FOR REVIEW OF THE DECISION OF THE TAX COURT OF THE UNITED STATES

BRIEF FOR THE RESPONDENT

THERON LAMAR CAUDLE,
Assistant Attorney General.

ELLIS N. SLACK,
A. F. PRESCOTT,
EDWARD J. P. ZIMMERMAN,
Special Assistants to the Attorney General.

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CITATIONS

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OPINION BELOW

The memorandum findings of fact and opinion of the Tax Court (R. 34-52) are unreported.

JURISDICTION

This petition for review (R. 59-65) involves federal income and victory tax for the taxable year 1943. On June 5, 1947, the Commissioner of Internal Revenue mailed to the taxpayer a notice of deficiency in the total amount of $18,632.28. (R. 12-24.) Within 90 days thereafter and on June 30, 1947 (R. 1), the taxpayer filed a petition (R. 4-11) with the Tax Court for a redetermination of that deficiency under the provisions of Section 272 of the Internal Revenue Code. The decision of

the Tax Court modifying the deficiency was entered March 28, 1949. (R. 52-53.) The case is brought to this Court by a petition for review filed June 24, 1949 (R. 59-65), pursuant to the provisions of Section 1141 (a) of the Internal Revenue Code, as amended by Section 36 of the Act of June 25, 1948.

QUESTIONS PRESENTED

1. Whether taxpayer's share in the net income of a partnership between him and his father was his community or separate income. This in turn depends upon a determination of whether taxpayer received his interest in the partnership from his father by way of sale or by way of gift.

2. Whether taxpayer's accrued California income tax on his income from the partnership business was deductible in computing his income subject to the victory tax.

STATUTES INVOLVED

The pertinent statutes involved are to be found in the Appendix, *infra*.

STATEMENT

The facts as found by the Tax Court (R. 36-44) may be summarized as follows:

At all times material to this proceeding taxpayer was a resident of Stockton, California. His tax return for the year involved was prepared on a calendar year accrual basis. He reported his income and deductions on the community property method. (R. 36.)

On January 2, 1943, taxpayer and his father, R. Goold, entered into a partnership under the firm name of R. Goold & Son for the purpose of operating a business which taxpayer's father had theretofore conducted as a sole proprietorship. On that date the father executed a bill of sale purporting to transfer to taxpayer an undi-

vided one-half interest in all of the former's business assets described in the document, as follows (R. 36-37):

A. Eddy Electric and Mechanical Company. Assets valued at	$32,560.83
B. An undivided one-half interest in the R. Goold and A. E. Downer joint venture as shown upon the book of accounts	51,496.04
C. An undivided one-half interest in the R. Goold and F. R. Zinck joint venture as shown upon the book of accounts	$10,115.09
D. An undivided one-half interest in the R. Goold and A. R. Liner joint venture as shown upon the books of accounts	2,500.00
E. An undivided one-half interest in the R. Goold and C. L. Wold joint venture as shown upon the book of accounts	25,000.00
F. An undivided one-half interest in the "Marysville" Contract as shown upon the book of accounts	40,000.00
Total	$161,671.96

The property so described was owned prior to the transfer by the taxpayer's father and mother as their community property. In addition, they owned other community property of a value in excess of $83,000. They were the parents of another child, a daughter, who was two years older than taxpayer. (R. 37.)

The recited consideration for the transfer of the one-half interest was the execution and delivery by taxpayer of a non-interest bearing note in the amount of $100,000, payable at the rate of "twenty-five (25%) per cent or more of the annual profits which shall be made to and received by me out of the operation of said business." (R. 37.)

At the time of this transaction with his father, taxpayer owned a small home, an automobile, and four shares of stock of the Union Oil Company. (R. 38.)

Item A of the bill of sale represented the value of the assets of the Eddy Company, which was engaged in the business of the installation of wiring systems and the sale of electrical materials, supplies, and appliances.

Items B to F, inclusive, consisted of the known and estimated share of the profits of taxpayer's father in certain joint ventures for the performance of various Government contracts in the general area of Stockton, California. Taxpayer's father received his share of the profits in each of the joint ventures primarily for undertaking the responsibility of financing them in whole or in part. Such financing as was necessary had been arranged and completed by taxpayer's father prior to January, 1943. The accounting and handling of money for the joint ventures was done in the office of taxpayer's father in order to safeguard his interests in connection with their financing. (R. 38.)

The documents incident to the January, 1943, transaction were drafted and the terms and conditions determined by Lafayette J. Smallpage, an attorney, by whom, together with Frank Scott, an accountant, the entire arrangement was devised, after consultation with taxpayer's father. The attorney determined that the face amount of the note should be in the sum of $100,000, that no interest should be payable, and that the manner of repayment should be as recited in the note. (R. 38.)

The note contained the following endorsements on the back, all being in the handwriting of the attorney except those for 1944 and 1945, which were in the handwriting of the accountant (R. 39):

12/25/43	Gift	3,000.00
12/31/43	Credit by Error made in Computation of Value of Interest Sold	50,000.00
	Changed per authority of Smallpage 1/17/47	29,259.00
12/25/44	By gift	3,000.00
12/25/45	By gift	18,000.00
1/25/47	Earnings for 1945	7,107.42

At the time of the execution of the note and the bill of sale it was understood between taxpayer and his father that items E and F on the bill of sale, totaling

$65,000, were round figures representing as estimate of the father's share of the profits in the so-called Wold joint ventures, and that the figure would be subject to adjustment when the profits were known, with a corresponding adjustment to be made on taxpayer's note. (R. 39.)

The corrected figure was determined to be $44,810.04, which involved a decrease of $20,189.96, one half of which in the amount of $10,094.98 was included in the adjustments endorsed upon the note on January 17, 1947. That endorsement was in the sum of $29,259. (R. 39.)

Both taxpayer and his father were unfamiliar with the purpose and reasons for the various endorsements except that they did recognize that part of one endorsement was for the purpose of making the downward adjustment for profits from the Wold joint venture. (R. 39-40.)

At the time of the transaction and for some years prior thereto, taxpayer's father was not in good health and desired to bring taxpayer into the business. This matter had been the subject of discussions for some time between taxpayer and his parents and between his father and his mother. It was planned that taxpayer would first work in the business as an employee for a few years in order to determine whether he could undertake the rsponsibilities incident to partnership. Upon the establishment of his worth as an employee, his father then intended to offer him a partnership interest, which he did in 1943. (R. 40.)

The primary reason for having taxpayer execute the note at the time of the creation of the partnership was to fulfill his father's wish to deal fairly and equitably with both taxpayer and his sister, in so far as their destributive shares in their father's estate were concerned. It was intended that the balance remaining due on the note,

together with adjustments for gifts made by the father, was to be deducted from taxpayer's share in his father's estate in order to equalize the interest that taxpayer and his sister would receive upon their father's death. (R. 40.)

Taxpayer's share of the partnership business was not acquired by purchase. (R. 40.)

During 1943 taxpayer received from the partnership a drawing account of $200 per week, which represented a partial distribution of profits. He received no other profit distributions from the business in that year. (R. 41.)

During the taxable year taxpayer devoted all of his time to partnership business. His activities consisted principally of the supervision of the electrical house-wiring work of the Eddy Company, and the supervision of workers and the general management of some of the joint-venture activities. (R. 42.)

The reasonable value of taxpayer's personal services to the partnership in 1943 was $10,000, which is also a reasonable allowance as compensation for such personal services as he rendered to the business. (R. 42.)

On his 1943 tax return taxpayer reported total income for income tax purposes of $30,779.97, of which $30,258.37 was said to represent income from the partnership. He received salary and wages of $683.10 during the year and reported one-half thereof on his return. (R. 42.)

On his 1943 return, taxpayer also claimed a deduction for personal income tax payable to the State of California in the amount of $690.58 in computing income tax net income, and $688.45 in computing victory tax net income. In his notice of deficiency, the Commissioner allowed a deduction in the amount of $2,219.21 in the computation of income tax net income, but allowed no

deduction for the item in the computation of victory tax net income. (R. 43.)

On or about October 24, 1947, the office of the Franchise Tax Commissioner of the State of California sent taxpayer a formal notice of additional personal income tax proposed to be assessed, showing a proposed additional assessment in the amount of $1,484.51. Taxpayer duly filed with the Franchise Tax Commissioner a protest against the proposed additional assessment, contesting his liability for payment thereof. Taxpayer has not paid the proposed additional assessment and continues to contest his liability for the same. (R. 43-44.)

SUMMARY OF ARGUMENT

The Tax Court found that taxpayer did not receive his partnership interest from his father by way of purchase. This finding of fact, unless shown clearly erroneous by the taxpayer is binding upon this Court. Substance prevails over form in tax matters, and the Tax Court's conclusion that while the forms indicate a sale, the substance shows otherwise, is eminently correct.

Various circumstances indicate that, despite outward appearances, a sale was not intended—taxpayer was required to pay no interest on his promissory note nor was security required; neither taxpayer nor his father knew much of the details of the transaction by which taxpayer acquired an interest in the partnership; no adequate explanation was made of why payments on taxpayer's note to his father were not made; both partners placed extensive and somewhat vague reliance upon advice of counsel who attended to all details of the transaction; taxpayer's father really intended the outward manifestations of a sale as a protection to his daughter in the event of his decease, rather than as a bona fide sale.

For taxpayer to be entitled to deduct his California income taxes in computing victory net income the taxes

must be deductible under Section 23 (c) of the Internal Revenue Code and also incurred in connection with the carrying on of a trade or business. Like federal income taxes, taxpayer's state income taxes were a tax on personal income from the partnership. They were not taxes incurred because of partnership operations, but because of taxpayer's profit therefrom. They were, therefore, not incurred in the carrying on of a business.

ARGUMENT

I

The Tax Court's Finding that Taxpayer Did Not Receive His Share of the Partnership Business by Way of Purchase Was Not Clearly Erroneous and Therefore Binds this Court

The primary issue involved herein is whether taxpayer received his partnership interest from his father by way of sale or gift. If by sale, the taxpayer's partnership interest constitutes community property (California Civil Code (Chase, 1945), Sections 164, 687 (Appendix, *infra*)). But if the interest was acquired by gift from his father, then it is not community property but is the separate property of taxpayer (California Civil Code (Chase, 1945), Section 163 (Appendix, *infra*)), and income therefrom will be taxable, accordingly, entirely to him under Section 22 (a) of the Internal Revenue Code (Appendix, *infra*).

The Tax Court found that although the forms of a sale had been carried out, the transaction by which taxpayer acquired his partnership interest from his father was in substance a gift, in view of the circumstances involved. This finding is one of fact. *Manning* v. *Gagne,* 108 F. 2d 718 (C.A. 1st); *Smith* v. *Hoey* (S.D.N.Y), decided January 29, 1945 (34 A.F.T.R. 1704), affirmed, 153 F. 2d 846 (C.A. 2d). Accordingly, upon taxpayer falls the burden of proving the Tax Court's finding clearly erroneous, failing which it is conclusive upon this

Court. *Grace Bros.* v. *Commissioner,* 173 F. 2d 170 (C.A. 9th).

It is a familiar and basic rule of taxation that where form and substance conflict, substance prevails. *Gregory* v. *Helvering,* 293 U. S. 465. The form of words used and documentary recitals have no binding effect tested by what was in fact done. *Helvering* v. *Tex-Penn Co.,* 300 U. S. 481. Transactions between members of a family are peculiarly subject to the rule. Cf. *Commissioner* v. *Tower,* 327 U. S. 280; *Commissioner* v. *Culbertson,* 337 U. S. 733. It is clear that the Tax Court properly concluded that although the transaction herein between father and son, while formally a sale, was in fact and substance but a gift from father to son.

It would be virtually impossible to dignify the transaction as one at arm's length between taxpayer and his father, and therefore as a bona fide sale. As the Tax Court pointed out (R. 45):

> Such factors as the absence of interest, the vague and unexplained endorsements on the note, and the failure to make any payments on the note in the first few years, the only substantial offsets being in the form of gifts, undermine the result the petitioner wishes us to reach.

Not only did taxpayer allegedly purchase his partnership interest upon his non-interest-bearing note, the note was unsecured, and taxpayer stood but faintly behind it. He owned a small home, an automobile, and four shares of stock. (R. 38.) Taxpayer himself testified that he could not have borrowed $100,000 anywhere —save from his father—without paying interest. (R. 124.) It is dubious, with what security he could offer, whether he could have borrowed $100,000 anywhere else upon any terms. Taxpayer admitted that his arrangement with his father was "more than fair." (R. 124.)

There was, moreover, no consideration for the trans-

fer of partnership assets to taxpayer. His note was of no benefit to his father. Taxpayer was not obligated to pay anything to his father thereby, for the note provides (R. 57-58) that payment is to be made solely from expected annual profits of the partnership, solely, that is, from income which stems from the partnership interest taxpayer received from his father. In effect taxpayer pays to his father only that to which his father already had a right prior to the so-called sale. This is hardly a payment and connot be dignified as a consideration. The so-called promissory note is in substance more nearly a deed of gift than a promissory note. By the transaction taxpayer reseived a 50 percent interest in the assets of the partnership plus the right to share in 25 per cent of the partnership profits. His father retained a 50 percent interest in the assets of the partnership and *retained* the right to 75 percent of the profits. Taxpayer's credit is not truly pledged on the note, for failing profits from the partnership business he has no liability of payment thereon. There could be no default in payment without profits. Moreover, were the partnership to be dissolved, he would presumably have a right to his 50 percent share in the assets, whether payments had been made on the note or not. In such a situation, it is obvious that the Tax Court cannot be said to be clearly erroneous in concluding that there was no sale but merely a gift of taxpayer's partnership interest.

Taxpayer and his father knew little about the transaction. Taxpayer admitted that he knew practically nothing about the arrangements and depended upon his father and counsel. (R. 119-121, 124.) The entire deal was the creation of their attorneys. (R. 38, 72, 119, 139, 169-170, 172, 180, 196-197.) Both taxpayer and his father were at least vague, if not ignorant of endorsements made on the back of the note. (R. 39-40, 132-133, 134, 172-174, 175.)

Nor does taxpayer's explanation of why payments were not made out of profits seem satisfactory. Total profits for 1943, for example, were close to $120,000 (R. 125-126), out of which, according to the note, taxpayer would have been liable to pay his father $30,000. But no payments were made in that year. (R. 39, 126-127.) Taxpayer concedes that his case is weak in that payment was not made in the taxable year and some other years since he gave his note. (Br. 13.) No payments were made, upon advice of counsel, according to taxpayer's testimony (R. 126), and he *presumed* the reason for nonpayment to be the partnership's involvement in renegotiation proceedings. Some idea of the taxpayer's vagueness as to what went on can be gleaned from his testimony as to why no payments were made in 1943. Thus, he testified no payments were made because the partnership was under renegotiation and, further (R. 126-127)—

> Q. Did you talk that over with counsel?
> A. Yes, sir.
> Q. You, yourself, or did your father?
> A. Oh, Lord, I don't know.
> Q. You don't know?
> A. No, I don't.
> Q. Do you recall having a conversation with your father about whether or not you should make any payments?
> A. Well, we surely must have discussed it, or a payment would have been made, and I presume the reason for the payment not being made was that we were under renegotiation, and Mr. Smallpage was handling the renegotiation matters.
>
> * * * * *
>
> Q. When was all this renegotiation completed, do you recall?
> A. It was in the late spring or early summer of '43 or '44. '44, I believe.

Q. Yes. And was any attempt made at that time to make any adjustment on this note for the profits that you had received from the business in the preceding years?

A. No, sir.

Subsequently, taxpayer testified, things were again "in a turmoil" as a result of activity of the Internal Revenue Department (R. 127), but this hardly explains continued nonpayment on the note. The explanation seems even less convincing in view of the fact that even while matters were in a turmoil taxpayer's father saw fit to satisfy part of the obligation represented by the note by making gifts to taxpayer. (R. 39.) Moreover, as taxpayer points out (Br. 14), considerable time elapsed between the settlement of renegotiation proceedings and the commencement of Bureau investigation. The record also shows that no insistence was made that taxpayer pay up on his obligations under the note; that payments were apparently only made as the spirit moved taxpayer and his father; and that even while payments for some years were not made, allegedly because of confusion attending Bureau activity, payments were made for other years, just as taxpayer's father made gifts to him. (R. 176-181.) And yet, while taxpayer and his father testified many times that they were acting throughout on advice of counsel (R. 38, 72, 127, 132, 139, 169-170, 172, 180), these payments and gifts were made in the face of counsel's advice to "do nothing with the note" until the matters in turmoil might be straightened out (R. 177). Moreover, the fact that confusion attending Bureau investigation of partnership affairs had the effect of stopping payments on the note, as taxpayer and his father insist, lessens its effect as a bona fide and binding obligation. If the note were what it purported to be, payments should have been made on it regardless of Bureau activity, and not only on advice

of counsel. Both taxpayer and his father appear to have regarded all "these operations" (R. 196) most casually, and by no means in a manner suggesting that a real sale had been made.

Perhaps most important as an indication of the true intent of the parties in the transfer of the partnership interest to taxpayer lies in the reason behind it. As the Tax Court concluded (R. 46):

> When the transfer of the interest in the business was in reality a gift to the son in the nature of an advancement of an inheritance or legacy, a note was executed by the son, which was not intended by the parties to be evidence of a presently-enforceable debt arising out of a business transaction, but to be evidence of an advancement and which would serve as a means of equalizing, as between petitioner and his sister, the share of the father's estate which he would receive upon the latter's death.

Thus, taxpayer testified as to his father's intent when the alleged sale took place (R. 120):

> A. At the time he told me that he couldn't give me a half interest in the business because it would be unfair to my sister.
>
> Q. Yes.
>
> A. And that is why the promissory note was executed, and it was to be taken from my estate in the event of his death, in the event of his death I would have to pay back, I would have to pay back all the gift portion of that that had been assigned on the back of the note.
>
> Q. He said what?
>
> A. He said that any time—it would not be fair to my sister, he put this down advisedly, it would not be fair to my sister for him to give me a portion of the business, that I must purchase it.

(See also R. 122-123.) Had there been a bona fide sale, taxpayer's father would not need to have concerned himself with whether either his son or his daughter was

being preferred. Had there been a bona fide sale, the father's estate would have suffered no diminution, for the *forms* of the sale indicate full payment for value received.

In view of the foregoing, it cannot be said that the Tax Court's conclusion of fact that taxpayer did not receive his partnership interest by way of purchase is clearly erroneous. We submit that taxpayer has not borne his burden of proving the Tax Court wrong. He emphasizes in his brief the self-serving statements of the parties that a sale was intended but cannot overcome external circumstances upon which the Tax Court relied. And we submit that taxpayer's extensive quotations from the transcript (Br. 22-54) do not serve to show that the Tax Court's findings of fact were clearly erroneous.

II

The Tax Court Did Not Err in Denying Taxpayer a Deduction for His California Income Taxes

Taxpayer's second point of argument is that the Tax Court committed error in not allowing a deduction for state income taxes in computing his victory tax net income under Section 451 (a) (3) of the Internal Revenue Code (Appendix, *infra*). That section provides for the deduction of taxes to the extent that they are deductible under Section 23 (c) of the Internal Revenue Code (Appendix, *infra*) and, as a second condition, to the extent that the taxes are paid or incurred in connection with the carrying on of a trade or business.

The Tax Court has twice determined that state income taxes on individuals are not deductible within the meaning of Section 451 (a) (3). *Harris* v. *Commissioner,* 10 T.C. 818, affirmed without discussion of this point, 175 F. 2d 444 (C.A. 9th); *Whitman* v. *Commissioner,* 12 T.C. 324, affirmed without discussion of this point, December 22, 1949 (C.A. 2d). We submit that these deci-

sions are correct, and that the Tax Court did not err in its reliance upon the *Harris* case.

In enacting the provisions of Section 451 (a), the Committee on Finance (S. Rep. No. 1631, 77th Cong., 2d Sess., p. 8 (1942-2 Cum. Bull. 504, 509)) made the following significant comment in regard to it:

> Since the Victory tax does not allow any deduction for State income taxes, your committee deemed it advisable to provide that the total income tax and the Victory tax should not exceed 90 per cent of the taxpayer's net income.

Also see I.T. 3644, 1944 Cum. Bull. 372-373, in which it was held that personal income taxes are not deductible in computing victory tax net income under Section 451 (a).

As this Court undoubtedly knows, the California statute, under which taxpayer was liable for the taxes he seeks to deduct, is entitled "The Personal Income Tax" (3 Deering's California General Laws, Act 8494) and contains many provisions very similar to those found in the federal income tax law. This is particularly true as to the definitions of net and gross income and as to its treatment of partnerships. 3 Deering's California General Laws, *supra,* Sections 6, 7 and 22. Thus, it seems evident that the California income tax, like the federal income tax, is a personal income tax and is imposed on income from all sources. We submit, accordingly, that it is not a tax which is paid as an incident to carrying on a business and does not come within any of the provisions of Section 451 (a) above. We do not dispute, for the sake of the instant case, that taxpayer's California income taxes may be deductible under Section 23 (c).

Taxpayer argues (Br. 58-59) that his partnership income was business income, incurred in connection with the carrying on of a business. His argument depends upon the proposition that if there were no partnership business, there would be no income, and that the income

is therefore business income within the meaning of Section 451 (a), and also that he received income from a business. But the tax on taxpayer's personal income from the partnership business is not an incident of that business, and is not paid, we submit, in connection with the carrying on of the business. Accord, *Harris* v. *Commissioner, supra.* It is merely the tax on personal receipt of income. The tax is not imposed upon the business.

CONCLUSION

The decision of the Tax Court is in accordance with law and its findings are not clearly erroneous. Therefore, it should be affirmed.

Respectfully submitted,

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ELLIS N. SLACK,
A. F. PRESCOTT,
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Special Assistants to the Attorney General.

FEBRUARY, 1950.

APPENDIX

California Civil Code (Chase, 1945):

§ 163. *Separate Property of Husband.* — All property owned by the husband before marriage, and that acquired afterwards by gift, bequest, devise, or descent, with the rents, issues, and profits thereof, is his separate property.

§ 164. *Community Property. — Presumption from Mode of Acquisition.*—All other property acquired after marriage by either husband or wife, or both, including real property situated in this State and personal property wherever situated, heretofore or hereafter acquired while domiciled elsewhere, which would not have been the separate property of either if acquired while domociled in this State, is community property; * * *

§ 687. *Community Property Defined.*—Community property is property acquired by husband and wife, or either, during marriage, when not acquired as the separate property of either.

Internal Revenue Code:

SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service * * * of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

* * * * *

(26 U.S.C. 1946 ed., Sec. 22.)

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * *

(c) [As amended by Sec. 202 of the Revenue Act of 1941, c. 412, 55 Stat. 687; Secs. 105, 122 and 158 of the Revenue Act of 1942, c. 619, 56 Stat. 798] *Taxes Generally.*—

(1) *Allowance in general.*—Taxes paid or accrued within the taxable year, except—

(A) Federal income taxes;

(B) war-profits and excess-profits taxes imposed by Title II of the Revenue Act of 1917, Title III of the Revenue Act of 1918, Title III of the Revenue Act of 1921, section 216 of the National Industrial Recovery Act, or section 702 of the Revenue Act of 1934, or Subchapter E of Chapter 2, or by any such provisions as amended or supplemented;

(C) income, war-profits, and excess-profits taxes imposed by the authority of any foreign country or possession of the United States, if the taxpayer chooses to take to any extent the benefits of section 131;

(D) estate, inheritance, legacy, succession, and gift taxes; and

(E) taxes assessed against local benefits of a kind tending to increase the value of the property assessed; but this paragraph shall not exclude the allowance as a deduction of so much of such taxes as is properly allocable to maintenance or interest charges.

(3) *Retail sales tax.*—In the case of a tax imposed by any State, Territory, District, or possession of the United States, or any political subdi-

vision thereof, upon persons engaged in selling tangible personal property at retail, which is measured by the gross sales price or the gross receipts from the sale or which is a stated sum per unit of such property sold, or upon persons engaged in furnishing services at retail, which is measured by the gross receipts for furnishing such services, if the amount of such tax is separately stated, then to the extent that the amount so stated is paid by the purchaser (otherwise than in connection with the purchaser's trade or business) to such person such amount shall be allowed as a deduction in computing the net income of such purchaser as if such amount constituted a tax imposed upon and paid by such purchaser.

* * * * *

(26 U.S.C. 1946 ed., Sec. 23.)

SEC. 451 [As added by Sec. 172 of the Revenue Act of 1942, c. 619, 56 Stat. 798]. VICTORY TAX NET INCOME.

(a) *Definition.*—The term "victory tax net income" in the case of any taxable year means (except as provided in subsection (c)) the gross income for such year (not including gain from the sale or exchange of capital assets as defined in section 117, or interest allowed as a credit against net income under section 25 (a)(1) and (2), or amounts received as compensation for injury or sickness which are included in gross income by reason of the exception contained in section 22 (b) (5)) minus the sum of the following deductions:

* * * * *

(3) *Taxes.*—Amounts allowable as a deduction by section 23 (c), to the extent such amounts are paid or incurred in connection with the carrying on of a trade or business, or in connection

with property used in the trade or business, or in connection with property held for the production of income.

* * * * *

(26 U.S.C. 1946 ed., Sec. 451.)

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No. 12,296

IN THE

United States Court of Appeals

For the Ninth Circuit

E. R. GOOLD,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

On Petition for Review of the Decision of the Tax Court of the United States.

REPLY BRIEF FOR THE PETITIONER.

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On Petition for Review of the Decision of the Tax Court of the United States.

REPLY BRIEF FOR THE PETITIONER.

The petitioner in this proceeding has timely filed his opening brief. The respondent's brief was received by counsel for the petitioner on February 4, 1950, and this reply brief should be filed ten days thereafter per this Court's Rule 20, Par. 4.

The parties herein are in agreement upon the issues involved. Our rebuttal follows the same order of presentation as in our opening brief.

FIRST QUESTION.

Respondent's counsel have exaggerated the alleged binding effect upon the Appellate Court of findings of ultimate fact by the Tax Court. Subsequent to the amendment of section 1141(a) of the Internal Revenue Code by section 36 of the Act of June 25, 1948, petitions for review of decisions of the Tax Court have been on a par with appeals from the United States District Courts as to the authority of this Court to review the findings of ultimate fact by the Tax Court to determine (1) whether such findings are supported by substantial evidence in the primary facts appearing in the stipulations of the parties and in the oral testimony and (2) whether they are in the judgment of this Court erroneous in law. The effect of the cited amendment of section 1141(a) of the Internal Revenue Code was to restore the rules existing before the development of a contrary doctrine declared by the Supreme Court in *Dobson v. Commissioner,* 320 U.S. 489 (1943), 88 L. Ed. 248, 64 S. Ct. 239, which restored rules are exemplified in the following cases: *Wilmington Trust Co. v. Helvering,* 316 U.S. 164 (1942), 86 L. Ed. 1352, 62 S. Ct. 984; *Bogardus v. Commissioner,* 302 U.S. 34 (1937), 82 L. Ed. 32, 58 S. Ct. 61; *Commissioner v. Rainier Brewing Co.* (C.C.A. 9, 1948), 165 F. (2d) 217.

With these rules in mind, it is urged on behalf of the petitioner that this Court of Appeals look through the so-called "findings" of the trial judge and make an independent examination of the primary facts

disclosed in the stipulations, exhibits and in the testimony of the witnesses of both parties and therefrom correct those findings which are based not on facts but on surmises, suspicions and obvious misinterpretation of testimony.

One of the most glaring of such false findings is that made by the trial judge in his opinion (R. 46) quoted by the respondent (Br. 13) as to the reason behind the transfer of the partnership interest from father to son by means of a bill of sale and a note in payment for the partnership interest sold, namely that the note "was not intended by the parties to be evidence of a presently-enforceable debt arising out of a business transaction, but to be evidence of an advancement and which would serve as a means of equalizing, as between the petitioner and his sister, the share of the father's estate which he would receive upon the latter's death." That remarkable conclusion has been drawn by an inexplicable *non sequitur* from the petitioner's attempt to explain in his testimony that a gift from father to son (petitioner) would have been a preference of one child over the other but that a sale by means of which the full value of the property transferred would—either in the form of the note or in proceeds of its liquidation—remain in the father's community property estate, thus negating any preference. The petitioner did not mention anything about an advancement of his inheritance and obviously had no such notion in mind. Cf. Par. (4) of the petitioner's opening brief, p. 9. We mention this finding especially because it is a crucial point in the trial

judge's argument in support of his conclusion of ultimate fact that this transfer in question was a gift and not a sale. Such a finding, so falsely based in the testimony, has all the earmarks of one made solely to bolster a prejudgment made irrationally on the basis of personal bias. The emphasis of the respondent's brief on this false finding indicates that his counsel recognize it as essential to their case for the approval by this Court of the trial judge's conclusion.

The only other argument of any consequence on behalf of the respondent, an alleged lack of value of the petitioner's note as consideration for the transfer, disregards completely the one-half interest of the maker of the note in the partnership business transferred to him in the same transaction, an interest in a growing and profitable business, as well as the value of the petitioner's services in the same business as an income-producing factor tending to make the partnership interest increasingly valuable and to keep it that way. The petitioner, aged 31, was in his prime (R. 68), he had served his apprenticeship in his father's business for 2½ years (R. 69), and has proved his value therein. The trial judge found the fair value of his services in the business to be $10,000.00 per year (R. 42, 47), twice the amount determined by the respondent in his statutory notice of deficiency. The arguments of respondent's counsel based on an alleged lack of valuable consideration are questionable to say the least, if not actually deceptive.

The respondent's counsel have pointedly avoided in their brief any reference to the prohibition set forth

in Section 172 of the Civil Code of the State of California upon gifts of community property without the written consent of the wife (quoted in full in petitioner's brief, p. 10), and it is suggested that such avoidance of a provision of law, the disregard of which is specifically assigned as an error of the Tax Court in the petition for review (R. 64), is based on their inability to find any means of overcoming the effect of such inhibition to utterly negative the trial judge's finding that the transfer of an interest in the father's business was in fact and in law a gift. This Court's attention is again called to the testimony of one of the respondent's witnesses, Mrs. Elizabeth Goold, wife of the petitioner (R. 82 to 84) which was positive to the effect that there was no gift, and to the failure of the respondent's attorney to put his other witness on this point, the mother of the petitioner, on the stand. Cf. the argument in petitioner's opening brief in paragraphs (6) and (7), page 11.

SECOND QUESTION.

The argument of respondent's counsel upon the second question which is based upon a question of statutory construction, fails completely to come down to the merits of the question. They merely cite the previous opinions of the Tax Court, *Anna Harris et al.,* 10 T.C. 818, and *Lucilla de V. Whitman,* 12 T.C. 324, the errors in which on this point were amply demonstrated in the petitioner's opening brief. The cited affirmation of the *Whitman* decision, by C.A. 2 (in

full 50-1 U.S.T.C., Par. 9110) does not indicate in any way that the question concerning victory tax net income was raised in the petition for review. Similarly, the cited *affirmation* of the *Harris* decision was in fact a reversal of the Tax Court's decision by this Court, likewise without any indication that the instant question was at issue in the petition for review. Such alleged affirmations are of no weight whatever.

The argument for the respondent further cites a ruling of the respondent's office, I.T. 3644, C.B. 1944, p. 372, which is merely a begging of the question, and quotes a statement of the Committee on Finance (S. Rep. No. 1631, 77th Cong. 2nd Sess., p. 8; C.B. 1942-2, pp. 504, 509) which was made with reference to section 456, Internal Revenue Code, limiting the amount of the victory tax in certain cases, and not, as incorrectly stated in the respondent's brief, in explanation of section 451(a)(3), *idem.* As has been shown in the petitioner's opening brief, pp. 60 et seq., the provisions of section 451(a)(3) are clear beyond any need for external aid, and it is not apparent what bearing the finance committee's casual and erroneous remarks as to the effect thereon in explanation of an entirely different provision of the statute can have on this Court's construction of the provisions of the law according to which the petitioner has claimed a deduction of California income tax in the computation of his victory tax net income.

CONCLUSION.

In view of the failure of respondent to show error in the conclusions reached by petitioner in his opening brief, it follows that the decision of the Tax Court here under review should be modified to correct the errors assigned in the petition for review, and that judgment should be given for petitioner as prayed for.

Dated, Stockton, California,
February 10, 1950.

Respectfully submitted,
LAFAYETTE J. SMALLPAGE,
Attorney for Petitioner.

No. 12297

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

HERMAN HAYMAN,

Appellant.

vs.

UNITED STATES OF AMERICA,

Appellee.

BRIEF OF APPELLEE.

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No. 12297

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

HERMAN HAYMAN,

Appellant.

vs.

UNITED STATES OF AMERICA,

Appellee.

BRIEF OF APPELLEE.

I.

Statement of Jurisdiction.

A. The United States District Court for the Southern District of California had jurisdiction over the Appellant and subject matter covered by the Indictment herein under the provisions of United States Code Title 18, Sections 78, 73 and 88 (1946 Ed.).

B. Defendant (Appellant) Herman Hayman was charged in Count One of an Indictment with falsely personating one Samuel T. Thompson, a true and lawful holder of a debt of, and due from the United States, to-wit, United States Treasury check No. 728,823, in violation of Section 78 of Title 18, United States Code. Appellant was charged in Count Two of the Indictment with falsely making, forging, and counterfeiting, and causing

and procuring to be falsely made, forged and counterfeited the endorsement and signature of the payee, to-wit, the endorsement and signature of Samuel T. Thompson, of United States Treasury check No. 728,823, in violation of Section 73 of Title 18, United States Code. Appellant was charged in Count Three with uttering and publishing as true and causing to be uttered and published as true, the false, forged and counterfeited endorsement and signature of the payee of United States Treasury check No. 728,823, to-wit, the false, forged and counterfeited endorsement and signature of Samuel T. Thompson, in violation of Section 73 of Title 18, United States Code. The offenses in Counts One, Two and Three of the Indictment are alleged to have occurred on March 26, 1946. Appellant was further charged in Count Four of the Indictment with falsely making, forging and counterfeiting, and causing and procuring to be falsely made, forged and counterfeited, the endorsement and signature of the payee of United States Treasury check No. 351,100, to-wit, the endorsement and signature of 1st Lieut. Charles A. Wilbun, in violation of Section 73 of Title 18, United States Code. Count Five charged that Appellant did utter and publish as true and did cause to be uttered and published as true, the false, forged and counterfeited endorsement and signature of 1st Lieut. Charles A. Wilbun, payee, of United States Treasury check No. 351,100, in violation of Section 73 of Title 18, United States Code. The offenses in Counts Four and Five are alleged to have occurred on March 6, 1946. Count Six charged that Appellant did conspire with others to make, forge and counterfeit and cause to be falsely made, forged and counterfeited, the endorsement and signature of the payee of United States Treasury check No. 351,100, payable to Lieut. Charles A. Wilbun, and to utter and publish as

true, and cause to be uttered and published as true, the false, forged and counterfeited endorsement and signature of the payee of said check, in violation of Section 88 of Title 18, United States Code.

C. After trial, upon a verdict of guilty, sentence was imposed, and Defendant Herman Hayman appealed from said judgment. Judgment was affirmed, and Appellant then filed Motions to Vacate and Set Aside Judgment and Sentence, and for New Trial, and Petition for Writ of Habeas Corpus, which Motions and Petition were duly denied by the Trial Court.

D. This Court has jurisdiction of the appeal under the provisions of Section 2255 of Title 28, United States Code.

II.

Statement of the Case.

The record will show that on January 7, 1947, Appellant was found guilty by the Court, trial by jury having been waived, of the violation charged in each of the six counts of the Indictment, and that he was thereafter sentenced as follows:

Count One—Imprisonment for 10 years and a fine of $2,000.

Count Two—Imprisonment for 10 years and a fine of $1,000.

Count Three—Imprisonment for 10 years and a fine of $1,000.

Count Four—Imprisonment for 10 years and a fine of $1,000.

Count Five—Imprisonment for 10 years and a fine of $1,000.

The periods of imprisonment under Counts One and Two to run consecutively; the periods of imprisonment under Counts Three, Four and Five to run concurrently with the period of imprisonment imposed under Count Two, making a total period of imprisonment of 20 years.

Count Six—A fine of $10,000, and the payment of a total fine of $10,000 to fully satisfy all fines imposed under Counts One to Six inclusive of the Indictment, and defendant to stand committed until said fine of $10,000 is paid.

Defendant then appealed from said judgment and sentence to the United States Circuit Court of Appeals for the Ninth Circuit, and on November 6, 1947, the aforesaid judgment and sentence was affirmed without opinion. (*Hayman v. United States,* 163 F. 2d 1018 (1947).

Thereafter, on May 11, 1949, Appellant filed Motion to Vacate Judgment and Sentence, and Petition for Writ of Habeas Corpus. [Tr. 2-13.] Said Motion and said Petition were duly considered by the Honorable Wm. C. Mathes, United States District Judge, and upon Findings of Fact and Conclusions of Law, an Order was entered by said Honorable Court denying said Motion and said Petition for Writ of Habeas Corpus.

Appellant then, within the time prescribed by law, filed his Notice of Appeal from said Order denying said Motion to Vacate Judgment and Sentence and for New Trial, and the record in this case was filed with the Clerk of this Honorable Court.

III.

ARGUMENT.

A. Defendant Claims He Was Arrested Without a Warrant and Was Held Five Days Before He Was Taken Before a Committing Magistrate.

The alleged lapse of time between the date when Appellant was taken into custody and the date of his arraignment before the United States Commissioner is immaterial because the government did not introduce or seek to introduce into evidence at the trial of the Appellant any confession or other incriminatory statements made by Defendant during that time.

> *United States v. Bayer, et al.,* 331 U. S. 532, 539-541 (1947).

It is to be further noted that the Learned Trial Judge, in his Findings of Fact, found that Defendant was taken into custody on November 6, 1946, and arraigned before the United States Commissioner on November 7, 1946, at Los Angeles.

B. Defendant Claims He Was Deprived of the Right to Have Assistance of Counsel for His Defense in That He Was Not Adequately Represented by Competent Counsel.

The Learned Trial Judge, in his Findings of Fact, found that Appellant was fully and fairly represented at all stages of the proceedings in this Court by counsel of his own selection, namely, A. P. Entenza. [Tr. 18.] The Court further found that neither Messrs. Walter L. Gordon nor E. S. Ragland, as successor counsel to A. P. En-

tenza, ever made any suggestion of complaint in this Court prior to the filing of Motion by Appellant on May 11, 1949, that Defendant (Appellant) had not been fully and adequately and competently represented by A. P. Entenza throughout the trial and at the imposition of sentence.

The Court further found from the evidence adduced at the time of hearing on the Motion to Vacate Judgment and Sentence, and for New Trial, that A. P. Entenza appeared as counsel for Juanita T. Jackson, but that he did so only with the knowledge and consent and at the instance and request of the Defendant (Appellant) Herman Hayman.*

C. Defendant Claims He Was Sentenced to Ten Years to Run Consecutively for Violations Charged in Count One and Count Two, and That These Counts Constitute But a Single Offense.

Count One of the Indictment charges a violation of Section 78 of Title 18 (1946 Ed.), United States Code—the false personation of one Samuel T. Thompson, a true and lawful holder of a debt of, and due from the United States, to-wit, United States Treasury check No. 728,823; and Count Two charges a violation of Section 73 of Title 18 (1946 Ed.), United States Code—the false making, forging and counterfeiting of the endorsement of

---

*Juanita T. Jackson was represented by A. P. Entenza at the time of her sentence in Cases No. 19064 CR., and No. 19065 CR., and was used as a government witness at the later trial of Herman Hayman (Appellant), No. 19036 CR.

the payee, namely, Samuel T. Thompson, of United States Treasury check No. 728,823. A conviction for the offense charged in Count Two required proof of facts not required to establish the offense charged in Count One. [Tr. 21.]

Reger v. Hudspeth, 103 F. 2d 825, 826 (C. C. A. 10, 1939).

Furthermore, there has been no showing that the sentences imposed for the violations charged in Counts Three, Four and Five, which are to run concurrently with the sentence imposed for the violation charged in Count Two, are sentences for the same offense as the one imposed on Count One. In fact, the contrary is to be found. Count Three charged the uttering of the forged endorsement and signature of Samuel T. Thompson on United States Treasury check No. 728,823. Count Four charged the forging of the endorsement and signature of Lieut. Charles A. Wilbun on United States Treasury check No. 351,100, and Count Five charged the uttering of the forged endorsement and signature of Lieut. Charles A. Wilbun on United States Treasury check No. 351,100. The offenses charged in Counts One, Two and Three were committed on March 26, 1946. The offenses charged in Counts Four and Five were committed on March 6, 1946.

Conclusion.

It is respectfully submitted that no irregularities occurred in the Defendant's arraignment, after commitment, and that no use of any confession or other incriminatory statements that would have affected Defendant's conviction was made at the trial; that the Defendant was fully and adequately represented by competent counsel at all stages of all proceedings in the Trial Court; that Appellant was not sentenced twice for a single offense as Count One and Count Two of the Indictment charge entirely separate and distinct offenses, and in any event, the sentences imposed on Counts Four and Five (which charged violations concerning a different check on a different date from the violations charged in Counts One, Two and Three), to run concurrently with the sentence imposed on Count Two, charge separate and distinct offenses with that involved in Count One; and that the Motion to Vacate Judgment and Sentence and to Grant a New Trial was properly denied by the Trial Court.

Respectfully submitted,

JAMES M. CARTER,
United States Attorney,

ERNEST A. TOLIN,
Chief Assistant U. S. Attorney,

NORMAN W. NEUKOM,
Assistant U. S. Attorney,
Chief of Criminal Division,

JACK E. HILDRETH,
Assistant U. S. Attorney,
Attorneys for Appellee.

No. 12297.

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

HERMAN HAYMAN,

Appellant,

vs.

UNITED STATES OF AMERICA,

Appellee.

PETITION FOR REHEARING.

ERNEST A. TOLIN,
United States Attorney,

RAY H. KINNISON,
Asst. U. S. Attorney,

JACK E. HILDRETH,
Asst. U. S. Attorney,

ROBERT J. KELLEHER,
Asst. U. S. Attorney.

600 United States Post Office and Courthouse
Building, Los Angeles 12, California,

Attorneys for Appellee.

Parker & Company, Law Printers, Los Angeles. Phone MA. 6-9171.

TOPICAL INDEX

TABLE OF AUTHORITIES CITED

No. 12297.

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

HERMAN HAYMAN,

Appellant,

vs.

UNITED STATES OF AMERICA,

Appellee.

PETITION FOR REHEARING.

The appellee hereby petitions this Honorable Court for a rehearing of the within appeal, the judgment on appeal herein having been filed October 27, 1950.

I.

Preliminary Statement.

This Court by a two to one vote of a three judge court ordered the judgment reversed and the motion dismissed in the Court below.

Separate concurring opinions, by Chief Judge Denman and by Judge Stephens, together with a dissenting opinion of Judge Pope were filed. Each opinion is grounded upon a different basic premise. The judgment of the Court is thereby rendered indefinite and the law uncertain upon questions of the highest importance in the administration of justice.

This petition for rehearing is made upon the ground that the opinion of the court should be restricted to the

issues raised by this appeal and thereby made definite and certain.

This petition is addressed to questions which were neither briefed nor argued before this Court. They are questions which the Court, very properly, raised, *sua sponte*. They are questions which the Court considered and answered in its opinions. Because the answers are non-uniform in the separate opinions of the Court we take this opportunity of suggesting a common ground and urging uniformity.

We urge that a rehearing be granted and that the Court thereupon order the judgment reversed and the cause remanded for further proceedings in the trial court with the appellant there present.

II.

The Attendance of the Appellant at the Hearing Below Is Available by Writ of Habeas Corpus Ad Testificandum.

The production of a prisoner before the convicting Court from a distant district can be accomplished by writ of *habeas corpus ad testificandum*. Even prior to the enactment of 28 U. S. C. 2255 the courts recognized that the writ was appropriate for this purpose. *Ex parte Bollman*, 4 Cranch 75, 8 U. S. 75, 2 L. Ed. 554; *Gilmore v. United States,* 10 Cir. (1942), 129 F. 2d 199; *Sanders v. Brady,* D. C. Md. (1944), 57 Fed. Supp. 87, 89. See also, *Barrett v. Hunter,* 10 Cir. (1950), 180 F. 2d 510, now on petition to the Supreme Court of the United States for writ of certiorari. Section 2255 does not limit or deny the writ for this purpose.

The attendance of the appellant would remove the objection that procedural due process was denied.

III.

Section 2255 Is Constitutional.

Section 2255 forms an integral part of the revised habeas corpus provisions of the new Judicial Code (28 U. S. C., Secs. 2241-2255). Chief Judge John J. Parker of the United States Court of Appeals for the Fourth Circuit, Chairman of the Judicial Conference Committee which drafted the revised habeas corpus provisions, in his article *Limiting the Abuse of Habeas Corpus,* 8 F. R. D. 171-178, describes the genesis and purposes of these revised provisions, including section 2255. He points out that a major purpose of the revised provisions generally, and of section 2255 in particular, was to correct certain flagrant abuses of the writ of habeas corpus by prisoners serving sentences imposed by courts of the United States, without in any way impairing the substantive rights which the writ of habeas corpus, as construed by decisions of this Court, was designed to protect. Thus, in his description of the purpose of section 2255, he points out (8 F. R. D. at 175):

> "Congress has not attempted to take away the right to make collateral attack on convictions obtained in violation of constitutional rights. It has provided, however, that, where conviction was had in the federal courts, this right must be asserted by motion before the sentencing court, and not before another court by application for habeas corpus, *unless it shall appear that the remedy by motion is not adequate.*" (Emphasis supplied.)

And, speaking of the last paragraph of section 2255, *supra*, he observes (*ibid.*):

> "It will be noted that this paragraph requires that the attack upon the judgment of imprisonment be

made in the court where it was rendered, where the facts with regard to the procedure followed are known to the court officials, and where the United States Attorney who prosecuted the case will be at hand to see that these facts are fairly presented. *Only where a judge to whom application is made for habeas corpus finds that the remedy by motion is "inadequate or ineffective to test the legality of the detention" is he authorized to entertain the application."* (Emphasis supplied.)

Judge Parker's conclusions reemphasize the point that no substantive rights of illegally imprisoned persons are affected by the revised provisions in general or section 2255 in particular (8 F. R. D. at 178):

> "* * * There is preserved in full the right of persons imprisoned under judgments of state and federal courts to ask release on the ground that they have been denied the sort of trial guaranteed by the Constitution; but effective provision is made against the unseemly incidents which have arisen in the assertion of the right. * * *
>
> It is believed that the effect of these provisions of the Revised Code will be to protect the courts in the administration of criminal justice from the delays, harassments and unseemly conflicts of jurisdiction which have arisen under recent habeas corpus decisions, without in anywise impairing the rights which it was the purpose of those decisions to protect. The habeas corpus procedure which led to abuse was laid down by the Supreme Court out of a desire that complete justice be done in every case. The provisions of the Revised Code preserved everything of importance in that procedure while eliminating the abuses to which it has given birth."

We think that it is thereby made clear that Section 2255 offers no infringement or limitation upon the constitutional privilege respecting the writ of habeas corpus.

In any event the necessities of this case require no consideration of the constitutional question.

We urge, therefore, that the judgment be reversed solely on the ground that a factual issue (*i. e.,* the effective conflict of assistance of counsel) is raised which requires appellant's presence at the hearing below.

IV.

The Grounds of and Reason for Reversal Should Be Clarified.

The Chief Judge in his opinion indicates that in the circumstances obtaining, the appellant was denied due process and, therefore, that the motion under Section 2255 is "inadequate and ineffective to test the legality of his detention."

Judge Stephens in his opinion indicates that "there is lack of due process inherent in the proceeding provided by the section (2255)."

If the opinion of the Chief Judge obtains as the opinion of the Court, then we urge that upon reversal the cause be remanded to the trial court for further hearing with the appellant present so as to afford him due process.

If the opinion of Judge Stephens obtains as the opinion of the Court then we urge that the Court make its grounds of reversal clear, in order that the important determination can be squarely made as to the constitutionality of Section 2255.

Conclusion.

Because the matters involved are of major importance, because they were never briefed or argued before this Court and because clarification is necessary and desirable in the interests of orderly administration of justice, we urge that a rehearing be granted.

The Government proposes, separately and apart from this petition, to make a motion before the Court that this matter be heard and determined *en banc*. (28 U. S. C. 46(c).) We do not herein petition the Court for a hearing *en banc* because this Court has held that such a *petition for rehearing en banc* is without authority in law or in the rules or practices of the Court. (*Kronberg v. Hale,* (9 Cir., 1950), 181 F. 2d 767; *Northwestern Mutual Life Ins. Co. v. Gilbert* (9 Cir., 1950), 182 F. 2d 256.) We do assert, however, that the importance of the matters involved warrant consideration by the full Court.

Respectfully submitted,

ERNEST A. TOLIN,
United States Attorney,

RAY H. KINNISON,
Asst. U. S. Attorney,

JACK E. HILDRETH,
Asst. U. S. Attorney,

ROBERT J. KELLEHER,
Asst. U. S. Attorney.

Attorneys for Appellee.

Certificate of Counsel.

I, Robert J. Kelleher, Assistant United States Attorney, one of the attorneys for the Appellee, hereby certify that in my opinion the within petition for rehearing is well founded and that the same is not interposed for delay.

ROBERT J. KELLEHER,
Asst. U. S. Attorney.

No. 12298

United States

Court of Appeals

For the Ninth Circuit.

ALASKA STEAMSHIP COMPANY, a Corporation,

Appellant,

vs.

M. P. MULLANEY, Commissioner of Taxation, Territory of Alaska,

Appellee.

Transcript of Record

Upon Appeal from the District Court for the Territory of Alaska Division Number One

Phillips & Van Orden Co., 870 Brannan Street, San Francisco, Calif.

No. 12298

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ALASKA STEAMSHIP COMPANY, a Corporation,

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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in italic; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in italic the two words between which the omission seems to occur.]

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ATTORNEYS OF RECORD

BOGLE, BOGLE & GATES,
FRANK L. MECHEM,

Central Building,
Seattle, Washington,

FAULKNER, BANFIELD & BOOCHEVER,
H. L. FAULKNER,

Juneau, Alaska.

For Appellants.

J. GERALD WILLIAMS,

Territorial Attorney General,
Juneau, Alaska.

For Appellee.

In the District Court for the Territory of Alaska, First Division

No. 6069-A

ALASKA STEAMSHIP COMPANY,
a corporation,

Plaintiff,

vs.

M. P. MULLANEY, Commissioner of Taxation, Territory of Alaska,

Defendant.

COMPLAINT FOR INJUNCTION AND OTHER RELIEF

I.

Plaintiff, Alaska Steamship Company, is a corporation organized and existing under the laws of the State of Washington with its office and principal place of business at Pier 42, Seattle, Washington. Plaintiff is qualified to do business in the Territory of Alaska and has paid all necessary license taxes required by the Territory of Alaska as a condition of doing business and has filed its annual report for the last calendar year.

II.

Defendant is an officer of the Territory of Alaska, residing in Juneau, in the Territory of Alaska, and can be found within said Territory of Alaska, and has been and now is the Commissioner of Taxation for the Territory of Alaska, authorized by law to

collect taxes for the Territory of Alaska and to enforce the tax laws of the Territory, and is sued on account of acts which he immediately intends and threatens to perform under color of law in his official capacity as such Commissioner of Taxation.

III.

This action arises under the Act of March 26, 1949, designated as Alaska Net Income Tax Act.

IV.

On February 4, 1949 the District Court of the United States for the Western District of Washington, Northern Division, issued a Preliminary Injunction against Plaintiff in that certain action known as John E. Humes, Bob Dombroff and Sailors' Union of the Pacific vs. Alaska Steamship Company, No. 2192. That Preliminary Injunction, which is still in full force and effect, required Plaintiff to place any and all amounts deducted and withheld from the earnings of members of the [1*] Sailors' Union of the Pacific in accordance with the withholding requirements of Sections 5-B and 8 of the Alaska Net Income Tax Act in a special fund, and, pending further order of the court, to retain and keep said fund, and enjoins Plaintiff from paying any part thereof to the Territory of Alaska. A certified copy of the Preliminary Injunction is attached to this complaint and made a part hereof, marked "Exhibit A." The complaint filed in this

*** Page numbering appearing at bottom of page of original certified Transcript of Record.**

action, pursuant to which the Preliminary Injunction was issued, alleged as the ground for the Preliminary Injunction the invalidity of Sections 5-B and 8 of the Alaska Net Income Tax Act as applied to seamen. A copy of that complaint is attached hereto and made a part hereof, marked "Exhibit B."

V.

On April 4, 1949 the District Court of the United States for the Western District of Washington, Northern Division, issued a Supplemental Preliminary Injunction against Plaintiff in the same action described in paragraph IV of this complaint, which continued in effect the Preliminary Injunction previously issued on February 4, 1949 and made the same applicable to withholdings made by Plaintiff from the earnings of members of the Sailors' Union of the Pacific in accordance with the withholding requirement of Sections 5-B and 8 of the Act of March 26, 1949, which repealed the Act of January 22, 1949, and was enacted in lieu thereof; both statutes being designated as Alaska Net Income Tax Act. A certified copy of the Supplemental Preliminary Injunction is attached to this complaint and made a part hereof, marked "Exhibit C."

VI.

Beginning with the payoff of the crew of the S.S. Chief Washakie, a vessel in the Alaska trade owned and operated by Plaintiff, on or about January 31, 1949, Plaintiff has deducted and withheld from the wages due and payable to the crew members of all

vessels owned or operated by Plaintiff, an amount equal to ten per cent (10%) of the tax deducted and withheld in accordance with the provisions of sub-Chapter (D), Chapter 9 of the Internal Revenue Code of the United States, as required by Sections 5-A and 8 of the Alaska Net Income Tax Act, which withheld amounts have been placed in the special fund and subject to the Preliminary and Supplemental Preliminary Injunctions described in paragraphs IV and V of this Complaint.

VII.

Defendant, purportedly acting pursuant to Section 8-D of the Alaska Net [2] Income Tax Act, has issued regulations requiring Plaintiff to pay over to the Territory of Alaska all amounts withheld and required to be withheld under Sections 5-B and 8 of the Act on or before April 30, 1949. Severe penalties are imposed by the Alaska Net Income Tax Act for failure to make payment of withheld amounts to the Territory of Alaska at the time required by Defendant's regulations.

VIII.

Plaintiff alleges that Sections 5-B and 8 of such Alaska Net Income Tax Act are invalid with respect to wages received by vessel personnel employed by Plaintiff, and that by reason of said Preliminary and Supplemental Preliminary Injunctions, Plaintiff is legally restrained from complying with such Sections of such Act and Defend-

ant's regulations purportedly issued pursuant thereto.

IX.

Plaintiff further alleges that such Alaska Net Income Tax Act is invalid in its entirety, and therefore necessarily invalid with respect to wages received by vessel personnel employed by plaintiff, because: (1) it violates the uniformity requirement of Section 9 of the Organic Act for the Territory of Alaska (37 Stat. 512); (2) it unlawfully attempts to delegate legislative functions to Congress and to the Commissioner of Internal Revenue; (3) it unlawfully attempts to delegate legislative functions to the Commissioner of Taxation for the Territory of Alaska; (4) it imposes a direct burden on interstate commerce in violation of the Commerce Clause of the Constitution of the United States (Article I, Section 8); (5) it fails to provide a proper allocation formula for fixing the amount of tax to be paid by persons having income from sources within and from without the Territory of Alaska; (6) it will effect such palpably arbitrary discriminations between tax-payers that it violates the Due Process and Equal Protection Clauses of Section 1 of the Fourteenth Amendment of the Constitution of the United States, and the Due Process Clause of the Fifth Amendment of the Constitution of the United States; (7) it is so vague and indefinite that it violates the Due Process Clauses of the Fifth and Fourteenth Amendments of the Constitution of the United States.

X.

Plaintiff is threatened with an immediate, substantial and irreparable injury for which it has no adequate remedy at law, because of Defendant's regulation and the provisions of Sections 5-B and 8 of the Alaska Net Income Tax Act requiring Plaintiff to withhold as therein provided upon the wages of vessel personnel [3] employed by Plaintiff and to pay the same over to the Territory of Alaska on or before April 30, 1949.

Wherefore, Plaintiff prays:

(1) That process issued against the Defendant to answer this complaint (but not under oath or affirmation and the benefit whereof is expressly waived by the plaintiff);

(2) That after notice and hearing, this Court grant to Plaintiff a Preliminary Injunction restraining Defendant from doing any acts or things for the purpose of collecting from Plaintiff any amounts withheld from vessel personnel pursuant to Sections 5-B and 8 of the Alaska Net Income Tax Act;

(3) And that upon final hearing this court enter a final order and decree to the same effect;

(4) That upon such final hearing this court enter an order adjudging and decreeing that:

(a) The Alaska Net Income Tax Act is null and void and of no legal effect;

(b) Sections 5-B and 8 of the Alaska Net Income Tax Act are null and void and of no legal effect with respect to wages received by vessel personnel employed by Plaintiff.

(5) And such other and further relief as to this court may seem meet.

ALASKA STEAMSHIP COMPANY,
By /s/ R. C. ANDERSON,
Executive Vice President,
FAULKNER, BANFIELD & BOOCHEVER,
By /s/ H. L. FAULKNER,
BOGLE, BOGLE & GATES,
By /s/ FRANK L. MECHEM,
Attorneys for Plaintiff. [4]

State of Washington,
County of King—ss.

R. C. Anderson, being first duly sworn, on oath deposes and says:

That he is Executive Vice President of Alaska Steamship Company, the plaintiff in the above-entitled action; that he has read the foregoing complaint and knows the contents thereof, and that the same is true as he verily believes.

[Seal] /s/ R. C. ANDERSON.

Subscribed and sworn to before me this 5th day of April, 1949.

/s/ LLOYD SHORETT,
Judge of the Superior Court of the State of Washington, in and for King County.

State of Washington,
County of King—ss.

I, Norman R. Riddell, County Clerk of King County and ex-officio Clerk of the Superior Court of the State of Washington for the County of King, do hereby certify that the Honorable Lloyd Shorett, who has signed the foregoing certificate, is the duly elected and qualified Judge of said Court, and that the signature of said Judge to said certificate is his genuine handwriting.

In Testimony Whereof, I have hereunto set my hand and affixed the Seal of said Court this 5th day of April, 1949.

[Seal] /s/ NORMAN R. RIDDELL,
Clerk. [5]

EXHIBIT A

In the United States District Court of the Western District of Washington, Northern Division

No. 2192

JOHN E. HUMES, BOB DOMBROFF and SAILORS' UNION OF THE PACIFIC, a voluntary association,

Plaintiffs,

vs.

ALASKA STEAMSHIP COMPANY, a corporation,

Defendant.

PRELIMINARY INJUNCTION

This matter comes regularly before the court upon the plaintiffs' complaint and application for a preliminary injunction, the plaintiff Bob Dombroff being present in person and all the plaintiffs being represented by John Geisness of Bassett & Geisness, their attorneys, and the defendant being represented by Stanley B. Long and Frank L. Mechem of Bogle, Bogle & Gates, its attorneys, notice of hearing upon said application for preliminary injunction being waived and the court having read and considered said complaint of the plaintiffs and an affidavit in support of said application for a preliminary injunction and having received testimony in open court in support of the allegations of said complaint, and having heard and considered the arguments and

statements of counsel for the respective parties; now, upon motion of the plaintiffs,

It Is Ordered that defendant Alaska Steamship Company, a corporation, place any and all amounts deducted and withheld from the earnings of the plaintiff John E. Humes or other unlicensed members of the deck departments of vessels operated by defendant in trade between Puget Sound, Washington, and Alaska points under claimed authority and requirement of a certain statute of the Territory of Alaska, and particularly Sections 5 and 8 thereof, purporting to authorize and require certain deductions and withholdings from the earnings of employees, entitled Alaska Net Income Tax Act, and approved by the Governor of the Territory of Alaska January 22, 1949, in a special fund to be entitled Alaska Withholding Fund and that, until further order of this Court, said defendant shall retain and keep said fund and shall pay no part of said fund to the Territory of Alaska and shall make no other, further or different disposition of the amounts so deducted and withheld. [6]

This preliminary injunction shall take effect upon the filing by the plaintiffs of a bond in the sum of $500.00 for the payment of such costs and damages as may be incurred or suffered by any party who is found to have been wrongfully enjoined or restrained.

Done in Open Court this 4th day of February, 1949.

LLOYD L. BLACK,
U. S. District Judge.

Presented by:

JOHN GEISNESS,

Of Attorneys for Plaintiffs,

and approved as to form. Copy received / and notice of presentation expressly waived.

BOGLE, BOGLE & GATES,

FRANK L. MECHEM,

Attorneys for Defendant.

I hereby certify that the annexed instrument is a true and correct copy of the original on file in my office.

Attest:

MILLARD P. THOMAS,

Clerk, U. S. District Court, Western District of Washington.

[Seal] By /s/ WALLACE PETERSON,

Deputy Clerk.

Received Feb. 4, 1949, United States Marshal, Seattle, Wash.

Served on W. P. McCarthy, C 3:20 P.M., Feb. 4, 1949.

Plaintiff's Exhibit No. 2 Received in Evidence April 22, 1949. [7]

EXHIBIT B

[Title of District Court and Cause.]

COMPLAINT

For cause of action plaintiffs allege:

I.

The defendant is and at all times herein mentioned has been a corporation organized and existing under the laws of the State of Washington and at all times herein mentioned said corporation has operated and still operates merchant vessels in maritime commerce between Puget Sound, Washington, and Alaska points, and does business in the Western District of Washington.

II.

At all times herein mentioned plaintiff John E. Humes has been and still is employed by the defendant as an unlicensed member of the deck department of the SS Chief Washakie, one of the vessels operated by defendant in said maritime commerce, and has been and is a member of the crew of said vessel. At all times herein mentioned plaintiff Sailors' Union of the Pacific has been and is a voluntary association of merchant seamen and each and all of the unlicensed members of the deck departments of said vessels operated by defendant in said maritime commerce have been and are members of said plaintiff association and said plaintiff association at all times herein mentioned has been and still is the duly authorized and established bar-

gaining agent for each and all of said employees with respect to the terms and conditions of their employment and particularly with respect to all of the matters and things that are the subject matter of this complaint. Plaintiff Dombroff is the Seattle agent for said voluntary association with respect to all of the matters and things that are the subject matter of this complaint.

III.

Defendant at present operates about 14 ships in said maritime commerce and [8] employes in excess of 250 unlicensed members of the deck departments on said vessels. Said employees are too numerous to be mentioned and with respect to the subject matter of this complaint are similarly situated with plaintiff John E. Humes and plaintiffs bring this action for and on behalf of all of said employees because they are too numerous to be individually joined. Most of said employees are not residents of Alaska.

IV.

On or about the 31st of January, 1949, certain shipping articles between the captain of the SS Chief Washakie, acting for defendant, and the crew thereof were terminated and the crew thereof was purportedly paid off by defendant through its representatives, but said defendant, through its agents, officers and representatives thereupon failed and refused to pay to said crew members or to any of them all of the wages then due to them, but de-

ducted therefrom, in addition to deductions authorized by federal law, an additional 10% of the tax deducted and withheld in accordance with the provisions of sub-chapter (D), Chapter 9 of the Internal Revenue Code of the United States and said defendant threatens to, and will, unless restrained by this court, retain and withhold from all future earnings of all seamen aboard said vessels said amount in addition to such deductions as are authorized by federal law. Said SS Chief Washakie on the voyage to which said shipping articles pertain operated a substantial part of the term of said voyage outside of Alaska waters upon the high seas, in foreign waters and in waters within the territorial limits of the State of Washington and a substantial part of the services through which said wages were derived were rendered in said waters, although portions thereof were earned while the vessel was in ports in the Territory of Alaska. During each and every future voyage of defendant's ships the ship engaged in each voyage will operate for a substantial part of the time consumed by such voyage upon the high seas or in foreign waters and waters within the territorial limits of the state of Washington and the earnings of each and all of the crew members on each of such voyages will be derived from services rendered in such waters.

V.

Defendant has withheld and retained said portion of earnings and threatens in the future to withhold and retain a like portion of all earnings

solely in reliance upon the purported validity of Section V and Section VIII of a purported statute enacted by the legislature of the Territory of Alaska and approved by the Governor of said Territory on the 22nd day of January, 1949. True and correct copies of said Sections V and VIII of said purported statute are attached hereto, [9] marked Exhibit A and incorporated herein by this reference.

VI.

As applied to plaintiff Humes and the other seamen on whose behalf this action is brought, said purported statute violates Article III, Section II, of the Constitution of the United States because it is an unwarranted invasion of the admiralty and maritime jurisdiction of the United States and, if applied to said plaintiff and said other seamen, does and will prejudice and adversely affect the uniformity and consistency of the general maritime law. As so applied said statute violates Article I, Section VIII of the Constitution of the United States in that it places an undue burden on interstate and foreign commerce and violates the Fourteenth Amendment to the Constitution of the United States because it places a tax upon earnings of nonresidents of Alaska derived from services rendered outside of Alaska and violates Article VI, Section II, of the Constitution of the United States because said withholding and deduction is and will be in violation of and contrary to the laws of the United States and particularly the provisions of Title 46

U.S.C.A. Sections 596, 597, 601, 605, 682, 683 and 685. The plaintiffs have no adequate remedy at law and will be irreparably injured unless defendant is enjoined and restrained from making said withholding and deduction and unless defendant is so enjoined and restrained there will be a multiplicity of suits to recover the amounts deducted and withheld. An emergency exists because defendant proposes and intends to commence voyages of certain ships in said maritime commerce within three days from the date hereof and defendant's unlicensed deck department employees are not willing to work aboard said ships when it is believed that defendant will, as expressly stated by it, withhold and deduct said amounts in violation of the constitutional and statutory rights of such employees. The amount in controversy in this action exceeds the sum of $3000.00, exclusive of interest and costs. All of said deducting and withholding has occurred and will occur within the Western District of Washington.

Wherefore, plaintiffs pray that this court issue an order restraining defendant until further order of this court from making any deduction from the pay of plaintiff Humes or other employees for and on whose behalf this suit is brought in purported reliance upon said act of the legislature of the Territory of Alaska and plaintiffs further pray for judgment and decree of this court declaring said Sections unconstitutional and invalid insofar as they purport to [10] authorize and require deductions

and withholding of any part of the earnings of crew members of ships operated by defendant in the trade hereinabove described and permanently enjoining and restraining the defendant herein from making said deductions and from withholding any part of said earnings in purported reliance upon said statute of the Territory of Alaska. Plaintiffs further pray for such other and further relief as to the court may appear just.

/s/ JOHN GEISNESS,
BASSETT & GEISNESS,
Attorneys for Plaintiffs.

United States of America,
State of Washington,
County of King—ss.

Bob Dombroff, being first duly sworn, on oath deposes and says:

That he is one of the plaintiffs in the above-entitled cause; that he has read the foregoing complaint, knows the contents thereof and believes the same to be true.

BOB DOMBROFF.

Subscribed and sworn to before me this 3rd day of February, 1949.

JOHN GEISNESS,
Notary Public in and for the State of Washington, residing at Seattle.

[Endorsed]: Filed April 8, 1949. [11]

EXHIBIT A

Section 5
Tax on Individuals, Fiduciaries, Corporations and Banks.

A. General Rule.

There is hereby levied and there shall be collected and paid for each taxable year upon the net income of every individual (except employees whose sole income in Alaska consists of wages or salary upon which tax has been withheld as referred to in subsection B of this section), fiduciary, corporation and bank, required to make a return and pay a tax under the Federal income tax law, a tax computed by either one of the following methods:

(1) a tax equal to 10 percent of the total income tax payable for the same taxable year to the United States under the provisions of the Internal Revenue Code, as computed without the benefit of the deduction of the tax payable hereunder to the Territory.

(2) a tax equal to ten percent of that portion of the total income tax payable under the provisions of the Internal Revenue Code, as computed without the benefit of the deduction of tax payable hereunder to the Territory, that gross receipts derived from sources within the Territory, payroll and value of tangible property located in the Territory, bears to the total gross receipts from sources within and without the Territory, payroll and value of tangible property within and without the Territory.

(a) Determination of Gross Receipts.

Gross receipts from sources within the Territory shall consist of interest rents, royalties, gains, dividends, all other income, and gross income received or derived in connection with property owned or a business or trade carried on and salaries, wages and fees for personal services performed within the Territory. Income received or derived from sales wherever made of goods wares and merchandise manufactured or originating in the Territory shall be considered to be a part of gross receipts from sources within the Territory.

(b) Determination of Property and Payroll Factors for Freight and Passenger Carriers.

The value of vessels operating on the high seas and compensation of employees engaged in operating such vessels shall be apportioned to the Territory in the ratio which the number of days spent in ports within the Territory bears to the total number of days spent in ports within and without the Territory. The value of aircraft and automotive vehicles operating as freight and passenger carriers from to and within the Territory and compensation of employees engaged in such operations, shall be apportioned to the Territory in the ratio which the number of days during which such services are rendered within the Territory bears to the total number of days during which such services are rendered within and without the Territory. [12]

(c) Apportionment of Tax by Tax Commissioner.

If the taxpayer, upon petition to the Tax Commissioner, as provided in Section 13 of this Act, conclusively demonstrates that because of other factors, the method of allocation hereinabove provided, results in a larger tax than in equity and good conscience he should have been required to pay, then the tax shall be determined, allocated and apportioned under such processes and formulas as the Tax Commissioner shall provide, and the Tax Commissioner may promulgate proper apportionment rules and regulations conformable with this Act for general application in similar cases. In the case of two or more organizations, trades or businesses owned or controlled directly or indirectly by the same interests, the Tax Commissioner is authorized to distribute, apportion, or allocate the tax where such action is necessary to prevent evasion of payment.

B. Employees.

There is hereby levied upon and there shall be collected from every employee (including persons referred to in subsection (C) of Section 1621 of the Internal Revenue Code) whose sole income in Alaska during the taxable year consists of wages or salary, a tax in the amount of ten percent of the tax deducted and withheld under the provisions of sub-chapter (D), Chapter 9, of the Internal Revenue Code, which tax is to be withheld by the employer under the provisions of Section 8 of this Act. The word "employer" includes all Territorial

departments, agencies and institutions and political subdivisions; Provided, that the foregoing language of this subsection shall not apply to Federal employees or others not subject to the withholding provisions of this Act, but such persons shall be liable under the general rule set forth in Section 5, and must file returns and make payment accordingly. [13]

Section 8.

Collection of Income Tax at Source.

A. Definitions.

As used in this section, with the exception of governmental employees, the terms "wages", "payroll period", "employee", and "employer" shall have the meaning attributed to such terms by subsections (a), (b), (c) and (d) respectively, of section 1621 of the Internal Revenue Code.

B. Requirement of Withholding.

Every employer making payment of wages or salaries shall deduct and withhold a tax in the amount of 10 percent of the tax deducted and withheld under the provisions of subchapter (D), chapter 9 of the Internal Revenue Code.

C. Rules Applicable.

The rules with respect to withholding of tax set forth in Section 1622 of the Internal Revenue Code shall apply with respect to this section as though fully set forth herein. Remittance of taxes withheld must be accompanied by returns on forms prescribed by the Tax Commissioner.

D. Payment of Tax Withheld.

Every employer making payments of wages—

(1) shall be liable for the payment of the tax required to be deducted and withheld under this section and shall not be liable to any individual for the amount of any such payment; and

(2) must make return of and pay to the Tax Commissioner quarterly, or at such other times as the Tax Commissioner may allow, the amount of tax levied which, under the provisions of this Act, he is required to deduct and withhold. Upon failure of the employer to comply with the provisions of this paragraph, the provisions of Section 11 of this Act shall apply.

E. Return and Payment by Governmental Employer.

If the employer is the United States or the Territory or a political subdivision thereof, or an agency or instrumentality of any one or more of the foregoing, the return of the amount deducted and withheld upon any wages or salaries may be made by any officer of said employer having control of the payment of such wages or salaries or appropriately designated for that purpose.

I hereby certify that the annexed instrument is

a true and correct copy of the original on file in my office.

Attest:

MILLARD P. THOMAS,

Clerk, U. S. District Court, Western District of Washington.

[Seal] By TRUMAN EGGER,

Chief Deputy Clerk.

4/5/49

[Endorsed]: Filed in the United States District Court, Western District of Washington, Northern Division, Feb. 4, 1949. [14]

EXHIBIT "C"

[Title of District Court and Cause.]

SUPPLEMENTAL PRELIMINARY INJUNCTION

This matter comes regularly before the court upon the plaintiffs' supplemental complaint and application for a preliminary injunction, the plaintiffs being represented by John Geisness of Bassett & Geisness, their attorneys, and the defendant being represented by Frank L. Mechem of Bogle, Bogle & Gates, its attorneys, notice of hearing upon said application being waived, and the court having read and considered the records and files herein and an affidavit supporting said application, and having heard and considered the arguments and statements

of counsel for the respective parties, now, upon motions of plaintiffs,

It Is Ordered that defendant Alaska Steamship Company, a corporation, place any and all amounts deducted and withheld from the earnings of the plaintiff John E. Humes, or other unlicensed members of the deck departments of vessels operated by the defendant in trade between Puget Sound, Washington, and Alaska points under claimed authority and requirement of a certain statute of the Territory of Alaska approved March 26, 1949, known as House Bill 92 and as Alaska Net Income Tax Act, purporting to authorize and require certain deductions and withholdings from the earnings of employees, in the special fund designated and described and provided for in the preliminary injunction entered herein February 4, 1949, and It Is Further Ordered that said preliminary injunction, entered February 4, 1949, is in all respects confirmed and continued in effect.

In view of the fact that said amounts deducted and withheld will remain in the care custody and control of defendant, defendant has waived the requirement of any additional bond, and no additional bond shall be required of plaintiffs.

Done in Open Court this 4th day of April, 1949.

JOHN C. BOWEN,
U. S. District Judge. [15]

Presented by:

JOHN GEISNESS,
Of Attorneys for Plaintiffs.

Copy received and approved as to form and notice of presentation expressly waived.

BOGLE, BOGLE & GATES,
FRANK L. MECHEM,
Attorneys for Defendant.

I hereby certify that the annexed instrument is a true and correct copy of the original on file in my office.

Attest:

MILLARD P. THOMAS,
Clerk, U. S. District Court, Western District of Washington.

[Seal] By TRUMAN EGGER,
Chief Deputy Clerk.

[Endorsed]: Filed in the United States District Court, Western District of Washington, Northern Division, April 4, 1949.

Plaintiff's Exhibit No. 3 Received in Evidence April 21, 1949. [16]

In the District Court for the Territory of Alaska,
First Division

No. 6069-A

ALASKA STEAMSHIP COMPANY,
a corporation,

Plaintiff,

vs.

M. P. MULLANEY, Commissioner of Taxation,
Territory of Alaska,

Defendant.

SUPPLEMENTAL COMPLAINT

Supplementing its complaint filed herein, plaintiff alleges:

I.

That for the reasons stated in paragraph IX of said original complaint, the Alaska net income tax is invalid in its entirety and therefore necessarily invalid with respect to wages received by employees of plaintiff who do not constitute vessel personnel.

II.

That the Act of January 22, 1949, known as The Alaska Net Income Tax Act, was and is invalid in its entirety with respect to wages received by all employees of plaintiff because the Special Session of the Legislature of the Territory of Alaska, which enacted said Act, was not a lawfully constituted session of said legislature and had no legal authority to enact such a law.

Wherefore, plaintiff prays:

(1) That paragraph (2) of the prayer for relief contained in the original complaint be expanded to include not only vessel personnel, but also all other persons employed by plaintiff and that paragraph (4) (b) of said prayer for relief be expanded to also include all other persons employed by plaintiff.

(2) That this Court grant to plaintiff a preliminary injunction restraining defendant from doing any act or thing for the purpose of collecting from plaintiff any amount withheld from any employees of plaintiff pursuant to Sections 5-B and 8 of The Alaska Net Income Tax Act of January 22, 1949, and that upon final hearing this Court enter an order adjudging and decreeing that said Alaska Net Income Tax Act of January 22, 1949, was and is null and void and of no legal effect.

ALASKA STEAMSHIP
COMPANY,
By FAULKNER, BANFIELD &
BOOCHEVER,
By BOGLE, BOGLE & GATES,
Attorneys for Plaintiff,
By FRANK L. MECHEM. [17]

United States of America,
Territory of Alaska—ss.

I, H. L. Faulkner, being first duly sworn, depose and say:

That I am attorney for Alaska Steamship Company, a corporation, the plaintiff herein above

named, and make this verification on its behalf, and that I make it for the reason that there is no officer or agent of the corporation available at the time and place where the verification is required to be made; and that I have read the foregoing supplemental complaint and know its contents and that the facts stated therein are true and correct, as I verily believe.

H. L. FAULKNER.

Subscribed and sworn to before me this 20th day of April, 1949.

[Seal] R. BOOCHEVER,
Notary Public for Alaska.

My commission expires: Oct. 20, 1951.

Copy received April 21, 1949.

JOHN H. DIMOND,
Attorney for Defendant.

Filed in the District Court, Territory of Alaska, 1st Division, at Juneau, April 21, 1949. [18]

PLAINTIFF'S EXHIBIT No. 1
(continued)

Plaintiff's Exhibit No. 1 consists of four forms, the original, duplicate, triplicate and work copy with carbon sheets between forms. Forms 2, 3 and 4 are duplicates of the preceding photostat with the exception of the bottom line, reading: Original —This copy shall be attached to the Original Summary in order of listing.

On the second form the bottom line reads: Duplicate—Seaman's Copy.

On the third form the bottom line reads: Triplicate—Operating Department Copy.

On the fourth form the bottom line reads: Work Copy.

AFFIDAVIT

No. 6069-A

Territory of Alaska,
First Division—ss.

W. P. McCarthy, being first duly sworn, upon his oath states that:

1. He is Assistant Treasurer of Alaska Steamship Company, a Washington corporation, with its office and principal place of business at Pier 42, Seattle, Washington, and that he has been employed by said Company for twenty-two years last past.

2. The Alaska Steamship Company is qualified to do business in the Territory of Alaska and has paid all necessary license taxes required by the Territory of Alaska as a condition of doing business and has filed its annual report for the last calendar year.

3. Affiant is, among other things, the Chief Auditor for the Company in charge of its Auditing Department and of all books and records of the Company pertaining to payroll and payroll taxes.

4. The Company operates, as a common carrier, passenger and freight vessels between Seattle, Washington, and various ports in Alaska, and between ports in Alaska, including Ketchikan, Wrangell, Petersburg, Sitka, Juneau, Cordova, Valdez, Seward, Kodiak, Seldovia, Nome, and all cannery ports and outports where business warrants.

5. The Company presently operates 12 vessels in the Alaska Trade, employing a total of 706 seamen, all of whom are nonresidents of the Territory of Alaska.

6. The Company presently averages four sailings per week from Seattle in the Alaska trade and approximately 75% of each voyage occurs within the Territorial waters of Alaska.

7. With respect to the seamen operating its vessels in the Alaska trade, a separate employment contract is entered into for each voyage at rates of pay set forth in the wage schedules of each contract. At the end of each voyage the seamen are paid off in Seattle, Washington, on the basis of an itemized wage statement which shows gross wages and deductions from such wages, including withholding for Federal income tax purposes and for Alaska income tax purposes. A copy of the wage statement form, designated as Seamen's State of Account, is attached hereto and made a part hereof, marked Exhibit "A." [20]

8. The total amount withheld from seamen's wages for the first quarter of 1949 in accordance with the requirements of Sections 5-B and 8 of the Alaska Income Tax Law was $7,399.75. The Company has continued to withhold income tax under the Alaska Income Tax Law on all voyages completed since the end of the first quarter of 1949 at the rates and in the manner prescribed by the Alaska Income Tax Law.

9. The Company maintains offices in the Territory of Alaska at Ketchikan, Juneau, Sitka, Cordova, Valdez, Seward, Kodiak, Nome, Anchorage and Fairbanks. These offices have a total of 19 employees who are residents of the Territory of Alaska

and the Company has withheld the required amount of tax under the Alaska Income Tax Law from the salaries paid to these employees.

10. On February 4, 1949, the Company was served with a preliminary injunction issued by the District Court of the United States for the Western District of Washington, Northern Division, in the case of John E. Humes, Bob Dombroff and Sailors' Union of the Pacific vs. Alaska Steamship Company, No. 2192, which required the Company to place any and all amounts deducted and withheld from the earnings of members of the Sailors' Union of the Pacific in accordance with the withholding requirements of Section 5-B and 8 of the Alaska Income Tax Law in a special fund, and, pending further order of the Court, to retain and keep such fund, and enjoin the Company from paying any part thereof to the Territory of Alaska. On April 4, 1949, the same Court issued a supplemental preliminary injunction against the Company in the same case which continued in effect the preliminary injunction previously issued on February 4, 1949, and made the same applicable to withholdings made by the Company from the earnings of members of the Sailors' Union of the Pacific in accordance with the withholding requirement of Sections 5-B and 8 of the Act of March 26, 1949, which repealed the Act of January 22, 1949, and was enacted in lieu thereof.

11. The Company has received from the Commissioner of Taxation for the Territory of Alaska

forms of returns together with instructions requiring the Company to pay over to the Territory of Alaska all amounts withheld and required to be withheld under Sections 5-B and 8 of the Alaska Income Tax Law on or before April 30, 1949.

12. As the only alternative to the filing of additional suits against the Company by the other seamen's unions in Seattle, Washington, the Company entered into agreements with those unions which agreements were identical in terms with the orders issued by the Court in the case of John E. Humes, Bob Dombroff and Sailors' Union of the Pacific vs. Alaska Steamship Company. Pursuant to these agreements the Company has withheld, in accordance with the requirements of the Alaska Income Tax Law, on the voyage pay of the seamen and has placed such withheld amounts in the Special fund created pursuant to the orders of the Court in Humes et al vs. Alaska Steamship Company.

13. Computations have been made, based upon the 1948 operations of the Company, for the purpose of ascertaining the effect of the taxing provisions of Section 5-A of the Alaska Income Tax Law upon the Company. Although no regulations have as yet been issued by the defendant in connection with the application of the allocation formula provided for by Section 5-A, the computations which the Company has made attempt, as closely as possible, to apply the formula as set forth in the statute. After making the computations it has been determined that approximately 45% of the amount of

the Company's Federal income tax, if any, would be subject to the 10% Alaska income tax as provided for in Section 5-A of the Alaska Income Tax Law.

14. The Company is presently operating as described in Paragraphs 4, 5 and 6 of this affidavit and intends to continue to operate in that manner throughout the remainder of the year 1949.

W. P. McCARTHY.

Subscribed and sworn to before me this 21st day of April, 1949.

[Seal] R. BOOCHEVER,

Notary Public in and for the Territory of Alaska, residing at Juneau.

Filed in the District Court, Territory of Alaska, 1st Division, at Juneau, April 22, 1949. [22]

SUPPLEMENTAL AFFIDAVIT

6069-A

United States of America,
Territory of Alaska—ss.

W. P. McCarthy, being first duly sworn, upon his oath states:

1. That the Alaska Steamship Company has 120 employees, other than shop employees and watchmen, who are non-residents of the Territory of Alaska, some of whom annually make trips to and spend substantial time in the Territory of Alaska upon business of the Company, including several such trips already made during the year 1949.

2. Of the amount of $7,399.75 withheld upon the wages of vessel personnel for the first quarter of 1949 under the Alaska Income Tax law, all but approximately $125.00 was withheld under the act of January 22, 1949.

3. For the first quarter of 1949, there was withheld upon the wages of other employees of the company the amount of $2,319.96 under the Act of January 22, 1949.

/s/ W. P. McCARTHY.

Subscribed and sworn to before me this 21st day of April, 1949.

[Seal] /s/ R. BOOCHEVER,
Notary Public for Alaska.

My commission expires October 20, 1951.

Copy received April 22, 1949.
/s/ MARTHA WENDLING,
Sec. to Atty. Gen'l.

Filed in the District Court, Territory of Alaska, 1st Division at Juneau April 22, 1949. [23]

[Title of District Court and Cause.]

ORDER TO SHOW CAUSE

This matter having come on upon the application of the plaintiff for an Order to Show Cause why a temporary restraining order should not be issued herein, and the sworn complaint of the plaintiff having been filed and considered, It Is Now, Therefore, Ordered

That the defendant be and he is hereby cited to appear before this Court at Juneau, Alaska, at ten o'clock A.M. on the 22nd day of April 1949 to show cause, if any there be, why an injunction pendente lite should not be granted restraining the defendant and all persons acting on his behalf from doing any act or thing for the purpose of collecting from plaintiff any amounts withheld from the wages of vessel personnel pursuant to Section 5-B and 8 of the Alaska Net Income Tax Act of March 26, 1949, during the pendency of this action, and until a trial of the issues which may be involved in the above-entitled cause may be had, and

It Is Further Ordered that a certified copy of this order be served upon the defendant not less than eight (8) days before the date of the hearing.

Dated at Juneau, Alaska April 8, 1949.

GEORGE W. FOLTA,
Judge.

Received April 8, 1949.
Civil Docket No. 26, P 265.
For Service by Deputy Hellan.
Filed and entered in the District Court, Territory of Alaska, 1st Division, at Juneau, April 9, 1949.

[Title of District Court and Cause.]

ANSWER

Comes now the defendant above-named, and in answer to plaintiff's complaint filed herein, admits, denies and alleges as follows:

I.

Answering Paragraph 1 of plaintiff's complaint, defendant alleges that he does not have facts sufficient to form an opinion as to the truth or falsity of the allegations contained therein, and, therefore, denies the same upon that ground.

II.

Defendant admits the allegations contained in Paragraph II of plaintiff's complaint.

III.

Defendant admits the allegations contained in Paragraph III of plaintiff's complaint.

IV.

Referring to Paragraph IV of Plaintiff's complaint, defendant alleges that he does not have sufficient information to form an opinion as to the truth or falsity of the allegations contained therein, and, therefore, denies the same upon that ground.

V.

Referring to Paragraph V of plaintiff's complaint, defendant alleges that he does not have sufficient information to form an opinion as to the truth or falsity of the allegations contained therein, and therefore, denies the same upon that ground.

VI.

Referring to Paragraph VI of plaintiff's complaint, defendant alleges that he does not have sufficient information to form an opinion as to the

truth or falsity of the allegations contained therein, and, therefore, denies the same [25] upon that ground.

VII.

Answering Paragraph VII of plaintiff's complaint, defendant admits the allegations contained therein.

VIII.

Answering Paragraph VIII of plaintiff's complaint, defendant denies the allegations contained therein.

IX.

Defendant denies each and every material allegation contained in Paragraph IX of plaintiff's complaint.

X.

Defendant denies the allegations contained in Paragraph X of plaintiff's complaint.

By way of reply to plaintiff's Supplemental Complaint filed herein, defendant denies and alleges as follows:

I.

Defendant denies the allegations contained in Paragraph I of plaintiff's supplemental complaint.

II.

Answering Paragraph II of plaintiff's supplemental complaint, defendant denies each and every material allegation contained therein.

III.

Defendant alleges that plaintiff's supplemental

complaint, filed herein on the 21st of April, 1949, alleges no facts material to the case occuring after the filing of the original complaint on April 8, 1949, as required by Sec. 55-5-82 ACLA 1949, and that the same should be dismissed for that reason.

Wherefore, defendant having fully answered the complaint and supplemental complaint filed herein by plaintiff, prays that the plaintiff take naught by reason thereof and that the same be dismissed with prejudice.

J. GERALD WILLIAMS,
Attorney General of Alaska.
Attorney for M. P. Mullaney, Commissioner of Taxation, Defendant. [26]

United States of America,
Territory of Alaska—ss.

J. Gerald Williams, being first duly sworn on oath, deposes and says: That I am the Attorney General of the Territory of Alaska, and by virtue of my official position, as one of the attorneys for the defendant named in the above and foregoing Answer; that I make this verification for and on behalf of the defendant for the reason that the defendant is not presently at Juneau, Alaska, the place where this verification is made, nor within one hundred miles thereof; that I have read the foregoing Answer and know the contents thereof, and that the same is true, as I verily believe.

J. GERALD WILLIAMS.

Subscribed and sworn to before me this 3rd day of May, 1949.

[Seal] MARTHA WENDLING,
Notary Public for Alaska.

My commission expires Nov. 1, 1949.

Copy Received, May 3rd, 1949.

FRANK L. MECHEM and
H. L. FAULKNER,
Attorneys for Plaintiff.

Filed in the District Court, Territory of Alaska, 1st Division, at Juneau, May 3, 1949. [27]

[Title of District Court and Cause.]

PRELIMINARY INJUNCTION

This matter comes regularly before the Court upon the plaintiff's Complaint and Motion for a Preliminary Injunction, the plaintiff being represented by H. L. Faulkner and Frank L. Mechem, its attorneys, and the defendant being represented by J. Gerald Williams, Attorney General, and John Dimond, Assistant Attorney General, and the Court having read and considered said Complaint and the affidavits in support thereof and having received testimony in Open Court in support of the allegations in said Complaint, and having heard and considered the arguments and statements of counsel for the respective parties; now, upon motion of the plaintiff

It Is Ordered that M. P. Mullaney, Commissioner of Taxation of the Territory of Alaska and the defendant herein, be and he is hereby temporarily enjoined from collecting or attempting to collect by any manner whatsoever amounts withheld by plaintiff from the wages and salaries of its employees as a tax under Sections 5-B and 8 of the Alaska Net Income Tax Act of January 22, 1949, and the Alaska Net Income Tax Act of March 26, 1949, pending final decision of this Court with respect to the validity of the said tax and provisions of the said Acts; and It Is Further Ordered that plaintiff shall pay into Court to be held and impounded therein during the period of this Temporary Injunction and until final decision of the Court, all amounts withheld and required to be withheld by plaintiff from the wages and salaries of its employees who are residents of the Territory of Alaska; and that these amounts be paid to the Clerk of the Court to be so impounded, at such times as the law requires or at such extensions thereof as may be granted by the Tax Commissioner of the Territory of Alaska.

Done in Open Court this 28th day of April, 1949.

GEORGE W. FOLTA,
Judge.

Approved as to form:

J. GERALD WILLIAMS,
Attorney General.

Filed in the District Court, Territory of Alaska, 1st Division, at Juneau, April 28, 1949. [28]

No. 6069-A

OPINION

Filed June 24, 1949

Faulkner, Banfield & Boochever, of Juneau, Alaska, and Bogle, Bogle & Gates, of Seattle, Washington, for plaintiff.

J. Gerald Williams, Attorney General of Alaska, and John Dimond, Assistant Attorney General of Alaska, both of Juneau, Alaska, for defendant.

Ralph J. Rivers, of Juneau, Alaska, as Amicus Curiae.

The first income tax statute for the Territory was enacted on January 22, 1949, as Ch. 3 of the Extraordinary Session of the Legislature convened on January 6, 1949. Because doubt was entertained as to the validity of the composition of the Extraordinary Session, the Legislature which convened in regular session on January 27, 1949, re-enacted its provisions, adding one for the ratification of the tax withholdings already made under the original act, and this act became Ch. 115.

In this suit plaintiff challenges not only the validity of the Extraordinary Session, and consequently the validity of the original income tax statute and everything done in pursuance thereof on the ground that the membership thereof was composed of those who were elected in 1948 and 1946 instead of those elected in 1946 and 1944, whose terms had not expired until the regular session was convened, but also challenges the validity of Chapter 115 on the following grounds: (1) that the pro-

vision for the adoption of future [29] amendments of the Federal Income Tax Law and the regulations thereunder constitutes a delegation of legislative authority to Congress and the Commissioner of Internal Revenue; (2) that the act is lacking in uniformity because a tax on income, being a property tax, cannot be graduated; (3) that the act burdens interstate commerce in the constitutional sense; (4) that payment of the tax is made a condition precedent to the right to carry on any business, including that in interstate commerce; (5) that the formula prescribed for the apportionment of the wages of plaintiff's nonresident seamen is discriminatory because it has not, in express terms, been made applicable to other nonresident employees of the plaintiff; (6) that the statute is void for indefiniteness and uncertainty because it fails to define the terms "income" in Section 5 A (2) (a), "days in port" in the succeeding paragraph, and "continental shelf" in Section 5 B (1); (7) that the withholding provision, so far as seamen are concerned, is in conflict with Section 601, Title 46, U.S.C.A., and therefore void; (8) that Section 7 D of the statute delegates legislative authority to the Tax Commissioner.

Plaintiff operates steamships between the State of Washington and the Territory of Alaska, employing more than 700 seamen whose wages are paid at the end of each voyage in Seattle. In a suit against the plaintiff, filed in the Federal Court in Seattle, the Sailors' Union of the Pacific has ob-

tained an injunction, restraining the plaintiff from paying to defendant the tax withheld from the wages of its members under Chapters 3 and 115. Plaintiff asserts that similar suits by other maritime unions on behalf of those members who are employed by plaintiff have been forestalled only upon agreeing to similarly impound the tax withheld from their wages pending the outcome of this litigation. [30]

1. Validity of the Extraordinary Session.

Plaintiff contends "that the members of the Legislature elected at the general Territorial election in October, 1946, being required to take office on the fourth Monday in January, 1947, and having a term of two years fixed for the members of the House and four years for the members of the Senate, were entitled to hold office and to exercise the functions of legislators for two years and and four years, respectively, from the fourth Monday in January, 1947, and that therefore when the Extraordinary Session was called to convene on January 6, 1949, that session should have been composed of those members who were elected in 1946, and not those who were elected in 1948. However, those who were elected in 1948 were called, appeared, organized and attempted to function as a Legislature regularly called, and they passed the first income tax law, Chapter 3 of the Laws of the Extraordinary Session, 1949."

Although the Organic Act for the Territory (Act of August 24, 1912, 37 Stat. 513, 48 U.S.C.A. 67,

et seq.) prescribes the terms of members of the House and of the Senate at two and four years, respectively, it does not fix the time for the commencement thereof. However, it does provide, as it has provided ever since its enactment despite amendments, that immediately after assembling the members of the Senate shall, by lot or drawing, be divided into two classes; that the seats of the members of the first class shall be vacated at the end of two years and the seats of the members of the second class shall be vacated at the end of four years, Section 68 and 69a. The general election is held in October of the even-numbered years, and the Legislature is regularly convened on the fourth Monday in January of the odd-numbered years. 48 U.S.C.A. 74. The successful candidates, therefore, take their seats at the first regular session following their election.

It would, therefore, appear that the provision for vacating the seats of the members of the Senate at the end of two and four years, 48 U.S.C.A. 68 and 69a, referring as it does to the time of taking their seats upon assembling for the regular session, contemplates that the terms shall begin upon taking their seats. But if any doubt remains on this score, it would seem to be dispelled by the fact that since it cannot be known until after the determination by lot or drawing whose term shall be vacated at the end of two or four years, manifestly their terms cannot begin until such determination. If this is the correct view, then it follows that the terms of

the members who were elected in October, 1946, and of the long-term members elected in 1944, who took their seats on the fourth Monday of 1947, did not expire until the convening of the Legislature in regular session on January 27, 1949, and that they, instead of those elected in 1948 and 1946, respectively, who were called, should have composed the membership of the Extraordinary Session of the Legislature convened on January 6, 1949. It would likewise follow, if this view is correct, that the acts of the Legislature at its Extraordinary Session, including the enactment of the first income tax law and everything done pursuant thereto, were without authority and, hence, void.

Defendant contends that the terms began when the Canvassing Board issued the certificates of election under the Act of March 26, 1934, 48 Stat. 465, 48 U.S.C.A. 144a which provides, so far as is material to this controversy, that:

"The said canvassing board shall commence the performance of its duties at the office of [32] the Governor within ten days after the second Tuesday in October in each year in which an election is held, * * * and shall continue with such work from day to day until the same is completed. * * * In case it shall appear to the board that no election return, as herein prescribed, has been received by the Governor from any precinct in which an election has been held, the said board may accept in place thereof the certified copy of the certificate of election for such precinct received from the clerk of the court,

and may canvass and compile the same with the other election returns. The canvassing board shall terminate the canvass and issue the certificates of election so soon as it is satisfied that no missing return would, if received, change the result of a canvass based upon the returns at hand, but when the board has information that an election was held at any precinct from which no return has been received and which return, if received, the board has reason to believe will affect the result of the election, it shall be the duty of the board to await the arrival of such return until 4 o'clock postmeridian on the 10th day of December in the year during which the election is held, but no longer, and any return received after that time shall not be counted by the board.

"Upon the completion of the said canvass as herein provided, the said board shall declare the person who has received the greatest number of votes for the office for which he is a candidate elected to such office for the term for which he is elected, and shall issue and deliver to him in writing, under their hands and seals, a certificate of his election."

It is clear that so far as terms are concerned, all that the Canvassing Board is empowered to do is to declare the term for which the successful candidate has been elected, not to fix the time for its commencement. That a definite time for the commencement of the terms of the members of the Legislature was intended is not only implicit in the provisions of the Organic Act already discussed, but

also is apparent upon general considerations. These lead to the conclusion that the terms of the members of the Legislature elected in 1946 began upon their assembling for the regular session on the fourth Monday of January, 1947, and taking the oath of office. Farrelly v. Cole (Kan.), 56 P. 492, 500. Further support for this conclusion may be found in the provision of Section 74, Title 48 U.S.C.A. [33]

"The Legislature of Alaska shall convene at the capitol at the city of Juneau, Alaska, on the fourth Monday in January in the year 1941 and on the fourth Monday in January every two years thereafter; but the said legislature shall not continue in session longer than sixty days in any two years unless again convened in extraordinary session by a proclamation of the Governor, which shall set forth the object thereof and give at least fifteen days' notice in writing or by telegram or radiogram to each member of said legislature, and in such case shall not continue in session longer than thirty days. The Governor of Alaska is hereby authorized to convene the legislature in extraordinary session for a period not exceeding thirty days when requested to do so by the President of the United States, or when any public danger or necessity may require it. Apr. 18, 1940, c. 105, Sec. 1, 54 Stat. 111."

Obviously, the word "again" in the foregoing provision would be rendered meaningless if any extraordinary session of the Legislature were called for a date subsequent to the issuance of the certi-

ficates of election but before the convening of the regular session, as was done in this instance.

Accordingly, it is my opinion that the Extraordinary Session was not constituted in accordance with law; that the original income tax statute enacted during the session was invalid and, therefore, that the tax withholdings made pursuant thereto were likewise invalid unless it was in the power of the Legislature to ratify them in accordance with Section 16 of the act. Whether this ratification provision of Section 16 may be given effect depends on whether the Legislature could have enacted the withholding provisions of Ch. 3. Manifestly, the invalidity which would preclude ratification must inhere in the act. If it merely goes to the composition of the Legislature, and the act is one within the legislative power, it would appear that it could be ratified. Whether the act, or at least the withholding provisions of the act if they are separable, were within the power of the Legislature, therefore, becomes the next subject [34] of inquiry.

2. Delegation of Legislative Functions to Congress and the Commissioner of Internal Revenue.

The tax levied under the act is upon the income tax payable to the United States under the Internal Revenue Code. This adoption of the provisions of the Federal Income Tax Laws and Regulations made pursuant thereto, would make possible the administration of the act at a minimum of cost with all the attendant benefits of uniformity. But, manifestly, the administration of the statute requires a

strict and immediate conformity with subsequent amendments of the Federal Law and Regulations. That the Legislature was fully cognizant of this requirement is attested by the provisions of Section 3 B that:

"Whenever the Internal Revenue Code is mentioned in this Act, the particular portions or provisions thereof, as now in effect or thereafter amended, which are referred to, shall be regarded as incorporated in this Act by such reference and shall have effect as though fully set forth herein.

"Whenever any portion of the Internal Revenue Code incorporated by reference as provided in Paragraph (1) of this subsection refers to rules and regulations promulgated by the United States Commissioner of Internal Revenue, or hereafter so promulgated, they shall be regarded as regulations promulgated by the Tax Commissioner under and in accord with the provisions of this Act, unless and until the Tax Commissioner promulgates specific regulations in lieu thereof conformable with this Act."

It is this part of the statute which is attacked as an attempt to delegate legislative power to Congress and the Commissioner of Internal Revenue. It must be admitted, however, that there is no delegation of authority to Congress or the Commissioner of Internal Revenue in express terms. The act merely provides for the conformity pointed out which is necessary to its life. Nevertheless, the weight of numerical authority supports the position of plaintiff and [35] would, if deemed controlling, preclude the Territory from availing itself

of the advantages to be gained from adopting the Federal Law. State v. Webber (Fla.), 133 A. 738; Florida Commission v. State, 21 So. 2d 599; Santee Mills v. Query (S. C.), 115 S. E. 202; Featherstone v. Norman (Ga.), 153 S. E. 58; In re Opinion of Justices (Mass.), 133 N. E. 453.

Obviously, if the Territorial Legislature were in session continuously, it would be in a position to adopt immediately each amendment to the Federal Laws and Regulations. But since it convenes biennially for a session of sixty days only, there was no alternative but the one to which it resorted. However, Ex parte Lasswell, 36 P. 2d 678, cited by the plaintiff supports the defendant's contention. In that case a provision in the California Industrial Recovery Act which, as in the instant case, had adopted a Federal act, to the effect that when the Federal authorities had fixed a code for the operation of any industry, that code would automatically become the state code, was upheld as against the contention that it was an unconstitutional delegation of legislative power, pp. 684-7. I am inclined to agree with the reasoning of this decision, and in any event the objection is not available to the plaintiff because it is not shown that there has been any amendment of either the Federal law or regulations since the enactment of Chap. 115 and, hence, it is not perceived how the constitutional rights of the plaintiff could have been infringed. Cf. Panama Refining Co. v. Ryan, 293 U. S. 388.

3. Uniformity.

The objection that the statute is wanting in uniformity and, hence, offends the due process and equal protection clauses of the Fourteenth Amendment is predicated [36] upon the proposition that a tax on income is a property tax and cannot be graduated. In support of the proposition that it is a tax on property, Pollock v. Farmers Loan and Trust Co., 157 U. S. 429, is cited. But aside from the fact that the Fourteenth amendment does not apply to the Territories, South Puerto Rico Sugar Co. v. Buscaglia, 154 F. 2d 96, 101; Anderson v. Scholes, 83 F. Supp. 681, 687; cf. Haavik v. Alaska Packers Association, 263 U. S. 510, it would appear, from what was said concerning the nature of a tax on income in Brushaber v. Union Pacific R. R., 240 U. S. 1, 16-17, and New York v. Graves, 300 U. S. 308, 315, that the implications of the Pollock case were misunderstood. Moreover, inequalities of the kind pointed out are not sufficient to invalidate tax legislation. Beers v. Glynn, 211 U. S. 477; St. Louis Land Co. v. Kansas City, 241, U. S. 419, 429. And speculation of the kind indulged in as to hardship and injustice in hypothetical cases cannot be considered by the courts.

4. Burden of Interstate Commerce
Formula Apportionment

The contention that the tax burdens interstate commerce in the constitutional sense is based on the fact that in hypothetical cases in which gross receipts (One of the factors of the formula set

forth in Section 5 A (1) (2) or apportioning income attributable to local activities) are derived wholly or nearly so from interstate commerce or outside activities, such as the sale of gold or salmon, and the components of the remaining factors are so negligible as to have little countervailing effect, the resulting fraction, so far as its numerator is concerned, makes the formula discriminatory to such an extent as to result in practical effect in imposing a burden on interstate commerce. The formula may be expressed as follows: [37]

$$\text{Fed. Income Tax without Deduction of Alaska Tax} \times \frac{\text{Local Gross Receipts}}{\text{Gross Rec. Everywhere}} \frac{\text{Payroll in Alaska}}{\text{Payroll Everywhere}} \frac{\text{Tangible Local Property}}{\text{Tangible Property Everywhere}} \times 10\% = \text{Tax}$$

However, not only are plaintiff's operations governed by another formula set forth in Section 5 A (2) (b) but specific provision is also made by Section 5 (2) (c) for cases in which either formula produces inequitable results. Moreover, since it is not shown that the plaintiff belongs to the class referred to in the hypothetical cases—a prerequisite to a consideration of the objection, Hatch v. Reardon, 204 U. S. 152, 160; Plymouth Coal Co. v. Pennsylvania, 232 U. S. 531, 544; Federation of Labor v. McAdory, 325 U. S. 450, 463, it cannot be heard to object on this ground.

5. Condition Precedent

The objection that Section 12 C makes the payment of the tax a condition precedent to the right

to carry on any business, including that in interstate commerce, is not reasonably susceptible of such a construction. The forfeiture of the license, where one may be required under other statutes, is made one of the consequences of nonpayment of the tax, not a condition to engaging in business in the first instance. Obviously, a forfeiture could not be incurred until after engaging in the business and becoming delinquent. Cf. Crutcher v. Kentucky, 141 U. S. 47, 56-7; International Textbook Co. v. Pigg, 217 U. S. 91.

6. Formula

It is also objected that no formula has been prescribed for the apportionment of salaries and wages of plaintiff's [38] nonresident employees who perform services in the Territory for a few weeks each year. But such an objection is not available to an employer. Mt. Timber Co. v. Washington, 243 U. S. 219, 234; Jeffrey Manufacturing Co. v. Blagg, 235 U. S. 571; Virginia Ry. v. Federation, 300 U. S. 515, 558.

7. Indefiniteness and Uncertainty

The statute is attacked for indefiniteness and uncertainty because it fails to define the terms "income" in Section 5 A (2) (a), "days in port" in the succeeding paragraph, and "continental shelf" in Section 5 B (1).

The context in which the term "income" is used makes its meaning reasonably clear. As to the term "days in port," since precision is not required in an apportionment formula and vessels are rarely

in port except to discharge or receive passengers or freight, the term may be construed as meaning the time the vessels are moored to a wharf or pier. Cf. Pierce Oil Co. v. Hopkins, 264 U. S. 137. The term "continental shelf" would not appear to be any more indefinite than the term high seas or limits of territorial waters. "Continental shelf" is defined by lexicographers as that portion of the ocean floor adjacent to a continent, within the one hundred fathom curve. It was not shown whether this curve has been delineated on charts of the United States Coast and Geodetic Survey. If it has not, it is obvious that there would be no way of determining whether a vessel in some cases was beyond or within the one hundred fathom line. But since the act contains a separability provision in Section 15, the clause in which the term "continental shelf" is employed must be examined to determine whether it may be eliminated without affecting the remainder of the act. The section containing the term reads that: [39]

"The tax levied by this subsection shall apply to that portion of the voyage pay of vessel personnel of interstate carriers engaged in the Alaska trade which is earned in the waters of Alaska, including the waters over the continental shelf. The tax shall likewise apply to that portion of the pay earned in Alaska of the personnel of carriers operating vehicles or airplanes on land or in the air on routes to and from Alaska."

Clearly the term is separable. El Paso and N. E.

Ry. Co. v. Gutierrez, 215 U. S. 87, 95-7; Electric Bond and Shares v. Commission, 303 U. S. 419, 434; Watson v. Buck, 313 U. S. 387, 396-7. And moreover its elimination and the consequent restriction of the statute to operations in territorial waters would merely limit the operation of the statute within the conceded jurisdiction of the Territory.

8. Conflict with Federal Statutes Relating to Seamen

It is also urged that the statute, so far as it requires withholding of the tax from the wages of seamen, is in conflict with 46 U.S.C.A., 601 providing:

"No wages due or accruing to any seamen or apprentice shall be subject to attachment of arrestment from any court, and every payment of wages to a seaman or apprentice shall be valid in law, notwithstanding any previous sale or assignment of wages or of any attachment, encumbrance, or arrestment thereon; and no assignment or sale of wages or of salvage made prior to the accruing thereof shall bind the party making the same, except such allotments as are authorized by this title. This section shall apply to fishermen employed on fishing vessels as well as to seamen: Provided, that nothing contained in this or sections 80, 569, 596, 597, 599, 656, 673, 701, 703, 712, and 713 of this title shall interfere with the order by any court regarding the payment by any seamen of any part of his wages for the support and maintenance of his wife and minor children. Mar. 4, 1915, c. 153, Sec. 12, 38 Stat. 1169."

and, hence, void. In support of this plaintiff cites American Hawaiian Steamship Co. v. Fisher, 82 F. Supp. 193. I am of the opinion, however, that there is no conflict between the two statutes. [40]

9. Delegation of Authority to Tax Commissioner

Section 7 D authorizes the Tax Commissioner to:

"Credit or refund all overpayments of taxes, all taxes erroneously or illegally assessed or collected, all penalties collected without authority, and all taxes that are found unjustly assessed or excessive in amount, or in any manner wrongfully collected. The tax Commissioner shall by means of rules and regulations specify the manner in which claims for credits or refunds shall be made, including adjustments with persons whose sole income in Alaska consists of wages or salary, prescribe limitations and give notice of allowance or disallowance. These rules and regulations shall be based upon the provisions of Secs. 321 and 322 of the Internal Revenue Code insofar as such provisions are consistent with other provisions of this Act. When refund is allowed to a taxpayer, same shall be paid out of the general fund on a Territorial warrant issued pursuant to a voucher approved by the Tax Commissioner."

The plaintiff contends that this constitutes a delegation of legislative authority. The authority conferred would, however, appear to be within the test laid down in Bowles v. Wallingham, 321 U. S. 503, 512-14, in which the Administrator of the Office of Price Administration was empowered to fix maxi-

mum rents which, in his judgment, would be generally fair and equitable in any defense rental area whenever in his judgment that action was necessary or proper in order to effectuate the purposes of the act, and further empowered to make adjustments for such relevant factors as he may determine and deem to be of general applicability, and to provide for such adjustments and reasonable exceptions as in his judgment are necessary and proper in order to effectuate the purposes of the act.

Accordingly, it is my opinion that the act is valid, from which it follows that it was within the power of the Legislature convened in regular session on January 27, 1949, to ratify and validate what was done under the withholding provisions of Ch. 3, People v. Fifer (Ill.), 117 N. E. 790; Board of Education v. Board of Commissioners (N. C.), 111 S. E. 531, 532; Anderson County Road Dist. v. Pollard (Tex.), 296 S. W. 1062; People v. Shriver (Ill.), 76 N. E. 2d 38, 42; Sutherland's Stat. Construction, Section 2219. The complaint should, therefore, be dismissed.

/s/ GEORGE W. FOLTA,
Judge.

Filed June 24, 1949. [42]

[Title of District Court and Cause.]

FINDINGS OF FACT AND CONCLUSIONS OF LAW

The above-entitled cause came on regularly for hearing on the 5th day of May, 1949, on the merits on the plaintiff's petition for an injunction before the Honorable George W. Folta, Judge of the above-entitled court. Plaintiff was represented by its counsel Frank L. Mechem of the firm of Bogle, Bogle and Gates of Seattle, Washington, and H. L. Faulkner of the firm of Faulkner, Banfield and Boochever of Juneau, Alaska; the defendant was represented by J. Gerald Williams, Attorney General of Alaska, and John H. Dimond, Assistant Attorney General of Alaska. Plaintiff having previously adduced oral testimony in support of its prayer for relief contained in its complaint and supplemental complaint, wherein plaintiff prayed for a preliminary injunction restraining defendant from doing any act or thing for the purpose of collecting from plaintiff any amount as income tax withheld from any employee of plaintiff pursuant to Sections 5B and 8 of the Alaska Net Income Tax Act and for an order adjudging and decreeing that said Alaska Net Income Tax Act is null and void and of no legal effect; and the court having considered said evidence and pleadings filed herein and having heard the arguments of counsel and having previously granted the preliminary injunction prayed for by plaintiff took said matter under advisement and on June 24, 1949, rendered its written opinion,

and said court does now in accordance therewith make and order entered the following [43]

FINDINGS OF FACT

I.

That Plaintiff, Alaska Steamship Company, is a corporation organized and existing under the laws of the State of Washington with its offices and principal places of business at Pier 42, Seattle, Washington. That Plaintiff is qualified to do business in the Territory of Alaska and has paid all taxes required by the Territory of Alaska as a condition of doing business and has filed its annual report for the last calendar year.

II.

That defendant is an officer of the Territory of Alaska, residing in Juneau, in said Territory, and can be found within said Territory of Alaska and has been and now is the Commissioner of Taxation for the Territory of Alaska, authorized by law to collect taxes for the Territory of Alaska and to enforce the Tax laws of the Territory.

III.

That this Action arises under the Act of March 26, 1949, designated as Alaska Net Income Tax Act.

IV.

That plaintiff is engaged in the operation of a line of vessels transporting freight and passengers between Seattle, Washington, and ports in Alaska,

and it was so engaged at all times mentioned in the complaint filed herein, and it is engaged in operating vessels in interstate commerce to and from Seattle, Washington, and all principal ports in the Territory of Alaska and to other points in Alaska including salmon canneries located therein. That in its Alaska trade said plaintiff was operating 12 vessels at all times and at other times operating more than 12 vessels in the Alaska trade; that it employes approximately 706 seamen who are non-residents of the Territory of Alaska and that at the time of the trial of this cause its operating schedule provides for 4 sailings a week from the port of Seattle to the Territory of Alaska.

V.

That approximately 75% of the time on the voyages of the plaintiff's vessels is spent in Territorial waters of Alaska and in waters off shore [44] from the coast of Alaska and that part of the voyages are made thru Canadian waters and part outside the 3 mile limit off the coast of Alaska.

VI.

That the seamen personnel belong to various Unions including the Sailors Union of the Pacific and all seamen aboard the vessels of plaintiff company including all deck crews are employed under union contracts and the seamen are paid off in Seattle at the end of each voyage and upon return of the vessel to Seattle and when payment is made the amount of pay due each man is computed according to the union scale and the union contract.

VII.

That under the provisions of the Alaska Net Income Tax Act plaintiff has deducted the sum of $7,399.75 from the wages of seamen for the quarter ending March 31, 1949.

VIII.

That the United States District Court for the Western District of Washington, Northern Division, in the case of John E. Humes, Bob Dombroff and Sailors Union of the Pacific vs. the Alaska Steamship Company, by its preliminary injunctions issued in that cause on February 4 and April 4, 1949, ordered the plaintiff herein to withhold the Alaska Net Income Tax from the wages of its seamen and the personnel of its vessels and to place the amount so withheld in a special fund subject to the order of that court, and it enjoined this plaintiff, Alaska Steamship Company, from paying any portion thereof over to the defendant as tax commissioner of the Territory of Alaska.

IX.

That the plaintiff, Alaska Steamship Company, has nineteen resident Alaska employees who are agents, assistant agents and shore employees, and that the plaintiff, Alaska Steamship Company, withheld the Alaska tax from their wages from the period from January 1, 1949, until the end of the March quarter, and that the amount so withheld was $2,319.96, and this has been impounded pursuant to the order of this Court.

X.

That the Tax Commissioner of the Territory of Alaska, the defendant herein, has made demand on the plaintiff for payment of the withholding tax under the Alaska Net Income Tax Act and plaintiff had no adequate remedy pending the decision in this case except by means of preliminary injunction which was issued by the Court herein.

XI.

That the extraordinary session of the Territorial legislature which convened on January 6, 1949, was composed of members who, with the exception of long term members elected in October, 1946, were elected in October, 1948, and whose terms would not commence until the convening of the legislature in regular session on January 27, 1949. That the terms of the members who were elected in October, 1946, and of the long term members elected in 1944 who took their seats on the 4th Monday of January, 1947, did not expire until the convening of the legislature in regular session on January 27, 1949, and that they should have composed the membership of the extraordinary session of the legislature which convened on January 6, 1949. That the Act of January 22, 1949, known as the Alaska Net Income Tax Act was invalid because the special session of the legislature of the Territory of Alaska which enacted said Act was not a lawfully constituted session of said legislature.

XII.

That the regular session of the 1949 Territorial Legislature re-enacted the Alaska Net Income Tax Act as Chapter 115, Session Laws of Alaska, 1949. That in accordance with Section 16 of said Chapter 115 the tax withholdings effectuated under the Alaska Net Income Tax Act as passed by the extraordinary session were ratified and confirmed.

XIII.

The term, "Continental Shelf," as it is used in Section 5B(1) of Chapter 115, Session Laws of Alaska, 1949, in the clause "including the waters over the Continental Shelf," although indefinite in its use may under the severability provision of Section 15 of the Act be eliminated without affecting the remainder of the Act.

XIV.

That the evidence and pleadings do not show that there has been any amendment of either the Federal Internal Revenue Code or the regulations [46] promulgated by the United States Commissioner of Internal Revenue since the enactment of Chapter 115, Session Laws of Alaska, 1949.

And, from the foregoing Findings of Fact, the Court does now make and enter the following

CONCLUSIONS OF LAW

I.

That the extraordinary session of the legislature which convened on January 6, 1949, was not constituted in accordance with law and that the pretended

income tax statute enacted during that session was invalid.

II.

That the tax withholdings made pursuant to Chapter 3 of the Extraordinary Session, referred to in the preceding paragraph are valid under the provisions of Section 16, Chapter 115, Session Laws of Alaska, 1949.

III.

That Chapter 115, Session Laws of Alaska, 1949, is a valid Act and that the temporary injunction granted herein on the 28th day of April, 1949, should be vacated and the complaint dismissed.

Plaintiff's exceptions are hereby allowed.

Done in Open Court at Juneau, Alaska, this 8th day of July, 1949.

/s/ GEO. W. FOLTA,
District Judge.

Filed in the District Court, Territory of Alaska, 1st Division, at Juneau, July 8, '49 P.M. [47]

In the District Court for the Territory of Alaska
Division Number One, at Juneau

No. 6069-A

ALASKA STEAMSHIP COMPANY,
a corporation,

Plaintiff,

vs.

M. P. MULLANEY, Commissioner of Taxation,
Territory of Alaska,

Defendant.

JUDGMENT AND DECREE

The above entitled cause came on regularly for hearing on the 5th day of May, 1949 on the merits on the plaintiff's petition for an injunction before the Honorable George W. Folta, Judge of the above entitled Court. Plaintiff was represented by its counsel Frank L. Mechem of the firm of Bogle, Bogle and Gates of Seattle, Washington and H. L. Faulkner of the firm of Faulkner, Banfield and Boochever of Juneau, Alaska; the defendant was represented by J. Gerald Williams, Attorney General of Alaska, and John H. Dimond, Assistant Attorney General of Alaska. Plaintiff having previously adduced oral testimony in support of its prayer for relief contained in its complaint and supplemental complaint, wherein plaintiff prayed for a preliminary injunction restraining defendant from doing any act or thing for the purpose of collecting from plaintiff any amount as income tax

withheld from any employee of plaintiff pursuant to Sections 5B and 8 of the Alaska Net Income Tax Act and for an order adjudging and decreeing that said Alaska Net Income Tax Act is null and void and of no legal effect; and the court having considered said evidence and pleadings filed herein and having heard the arguments of counsel and having previously granted the preliminary injunction prayed for by plaintiff, took said matter under advisement and on June 24, 1949 rendered its written opinion; and the Court being fully advised in the premises, having heretofore made and ordered entered its findings of fact and conclusions of law; now therefore, it is hereby [48]

Ordered, Adjudged and Decreed that Chapter 115, Session Laws of Alaska 1949 is a valid Act; and it is further

Ordered, Adjudged and Decreed that the preliminary injunction granted herein on the 28th day of April, 1949 be, and the same hereby is, vacated; and it is further

Ordered, Adjudged and Decreed that the complaint filed herein be, and the same hereby is, dismissed.

Plaintiff's exceptions are hereby allowed.

Done in open court at Juneau, Alaska, this 8th day of July, 1949.

/s/ GEO. W. FOLTA,
District Judge.

Filed and entered in the District Court, Territory of Alaska, 1st Division, at Juneau July 8, 1949. [49]

[Title of District Court and Cause.]

PETITION FOR ALLOWANCE OF APPEAL

The above named plaintiff, Alaska Steamship Company, a corporation, considering itself aggrieved by the Judgment and Decree made and entered in the above entitled court in this action on the 9th day of July, 1949, in favor of the defendant hereinabove named, and dismissing plaintiff's Complaint and dissolving the preliminary injunction, do hereby appeal from the Judgment and Decree of the above entitled court and the whole thereof, to the United States Court of Appeals for the Ninth Circuit at San Francisco, California, for the reasons specified and set forth in the Assignments of Error, which are filed herewith; and the plaintiff prays that this appeal may be allowed and that a transcript of the record, proceedings and papers, upon which the Judgment and Decree were made, duly authenticated by the Clerk of this Court, may be sent to the United States Court of Appeals for the Ninth Circuit at San Francisco, California.

Dated at Juneau, Alaska, the 9th day of July, 1949.

BOGLE, BOGLE & GATES,
FRANK L. MECHEM
FAULKNER, BANFIELD &
BOOCHEVER,
/s/ H. L. FAULKNER,
Attorneys for Plaintiff.

Copy received this 9th day of July, 1949.

J. GERALD WILLIAMS,
Attorney General, Territory of Alaska,
Attorney for Defendant,
By JOHN H. DIMOND,
Of Counsel.

Filed in the District Court, Territory of Alaska, 1st Division, at Juneau, July 9, 1949. [50]

[Title of District Court and Cause.]

ASSIGNMENTS OF ERROR

Comes now the above-named plaintiff and alleges that the Findings of Fact, Conclusions of Law and Decree of Judgment of the above-entitled Court entitled in this cause on the 8th day of July, 1949, are erroneous and unjust to plaintiff, and plaintiff files herewith its petition for allowance of appeal, the following Assignments of Error on which it will rely, namely:

I.

The Court erred in making and entering that portion of Finding No. XI, which reads as follows:

"That in accordance with Section 16 of said Chapter 115 the tax withholdings effectuated under the Alaska Net Income Tax Act as passed by the Extraordinary Session were ratified and confirmed."

II.

The Court erred in holding that the delegation of legislative functions to Congress and the Commissioner of Internal Revenue and the Tax Commissioner of Alaska under the provisions of Chapter 115, Session Laws of Alaska, 1949, is a valid delegation of authority.

III.

The Court erred in holding that the tax levied under the provisions of Chapter 115, Session Laws of Alaska, 1949, is uniform in its application.

IV.

The Court erred in holding Chapter 115, Session Laws of Alaska, 1949, to be valid, thereby holding that the tax did not burden interstate commerce [51] and that the formula for apportioning the tax does not produce inequitable results.

V.

The Court erred in holding that the provision in Chapter 115, Session Laws of Alaska, 1949, providing for forfeiture of license in case of non-payment of the tax is valid.

VI.

The Court erred in holding that the provisions of the law for apportionment of the tax between that portion of a taxpayer's income earned in Alaska and the total income earned both within and without the Territory is valid.

VII.

The Court erred in making and entering Finding of Fact No. XIII, which reads as follows:

"The term, 'Continental Shelf,' as it is used in Section 5B (1) of Chapter 115, Session Laws of Alaska 1949 in the clause 'including the waters over the Continental Shelf,' although indefinite in its use may under the severability provision of Section 15 of the Act be eliminated without affecting the remainder of the Act."

VIII.

The Court erred in holding that the tax levied under the Alaska Net Income Tax Law on the wages of seamen is valid.

IX.

The Court erred in making and entering its Conclusion of Law No. II, which read as follows:

"That the tax withholdings made pursuant to Chapter 3 of the Extraordinary Session, referred to in the preceding paragraph are valid under the provisions of Section 16, Chapter 115, Session Laws of Alaska 1949."

X.

The Court erred in making and entering its Conclusion of Law No. III, which reads as follows:

"That Chapter 115, Session Laws of Alaska 1949 is a valid Act and that the temporary injunction granted herein on the 28th day of April, 1949 should be vacated and the complaint dismissed." [52]

XI.

The Court erred in entering Judgment and De-

cree in favor of the defendant and dismissing the plaintiff's complaint and dissolving the Preliminary Injunction heretofore issued in this cause on April 28, 1949.

Wherefore, plaintiff prays that the Decree and Judgment and the Findings of Fact and Conclusions of Law upon which the Decree is based be set aside and the Preliminary Injunction heretofore issued on April 28, 1949, be made permanent.

Dated at Juneau, Alaska, this 9th day of July, 1949.

BOGLE, BOGLE & GATES,
FRANK L. MECHEM.
FAULKNER, BANFIELD & BOOCHEVER,
H. L. FAULKNER
By /s/ H. L. FAULKNER,
Of Attorneys for Plaintiff.

Copy received this 9th day of July, 1949.
/s/ J. GERALD WILLIAMS,
Attorney General, Territory of Alaska,
Attorney for Defendant.
By /s/ JOHN H. DIMOND,
Of Counsel.

Filed July 9, 1949. [53]

[Title of District Court and Cause.]

ORDER ALLOWING APPEAL

This matter coming on regularly before the Court on this 9th day of July, 1949, upon the petition of plaintiff above named for the allowance of an appeal in behalf of plaintiff from the Findings of Fact, Conclusions of Law and Judgment and Decree entered in this cause on July 8, 1949, and the plaintiff having filed its Assignments of Error,

Now, Therefore, It Is Ordered that the appeal of the plaintiff from the Findings of Fact, Conclusions of Law and Judgment and Decree entered herein on July 8, 1949.

Be And It Is Hereby Allowed to the United States Court of Appeals for the Ninth Circuit; and that a certified copy of the transcript of record, orders and all proceedings in this cause on which the Findings of Facts, Conclusions of Law and Judgment and Decree appealed from are based, be transferred, duly authenticated, to the United States Court of Appeals for the Ninth Circuit and therein filed, and the cause docketed on or before forty days from this date, to be heard before the Court at San Francisco, California, or such other place within the Ninth Circuit as may be designated.

It Is Further Ordered that the plaintiff herein file its cost bond on appeal in the sum of $250.00, with surety to be approved by the Court or the Clerk thereof.

Done In Open Court this 9th day of July, 1949.

/s/ GEO. W. FOLTA,
District Judge.

Copy received July 9, 1949.

J. GERALD WILLIAMS,
Attorney General of Alaska,
Attorney for Defendant.
By JOHN H. DIMOND,
Of Counsel.

Filed and Entered July 9, 1949. [54]

[Title of District Court and Cause.]

COST BOND ON APPEAL

Know All Men By These Presents:

That we, Alaska Steamship Company, a corporation, the plaintiff above named, as Principal, and the General Casualty Company of America, a corporation, authorized to transact surety business in the Territory of Alaska as Surety, are held and firmly bound unto the above named M. P. Mullaney, Tax Commissioner of the Territory of Alaska, the above named defendant, and his successors in office, for the benefit and indemnity of whom it may concern, in the penal sum of Two Hundred Fifty and no/100 ($250.00) Dollars, to be paid to the said M. P. Mullaney, the defendant above named, his successors or assigns, and for the benefit and indemnity of whom it may concern, for which payment well

and truly to be made we bind ourselves and our successors and assigns jointly and severally, firmly by these presents.

Sealed with our seals and dated this 9th day of July, 1949.

Whereas, on the 9th day of July, 1949, in a suit pending in the District Court for the Territory of Alaska, First Judicial Division, between the plaintiff and the defendant above named, a judgment was rendered in favor of the defendant and against the plaintiff, in which plaintiff's Complaint was dismissed; and the plaintiff has petitioned for and been allowed by the Court an appeal to the United States Court of Appeals for the Ninth Circuit, and a citation has been issued and directed to the defendant above named, citing him to appear in that court at San Francisco, California, within thirty days from and after the date of the citation;

Now, Therefore, The Condition Of This Obligation Is Such that if the plaintiff above named and the principal hereon shall prosecute its appeal to effect [55] and answer all costs, if the appeal be dismissed, or if it be affirmed by judgment of the appellate court, and all such costs as the appellate court may award, if the judgment should be modi-

fied, then this obligation to be void, otherwise to remain in full force and effect.

ALASKA STEAMSHIP
COMPANY,
a corporation,
By H. L. FAULKNER,
Its Attorney.

Principal:
GENERAL CASUALTY
COMPANY OF AMERICA,
a corporation, Surety,
[Seal] By STANLEY GRUMMETT,
Attorney-in-fact.

Copy received this 9th day of July, 1949.
J. GERALD WILLIAMS,
Attorney General, Territory of Alaska,
Attorney for Defendant.
By JOHN H. DIMOND,
Of Counsel.

Approved July 9, 1949:
GEORGE W. FOLTA,
U. S. Dist. Judge. [56]

Filed in the District Court, Territory of Alaska, 1st Division, at Juneau, July 9, 1949.

[Title of District Court and Cause.]

CITATION ON APPEAL

The President of The United States of America:

To the above-named M. P. Mullaney, Commissioner of Taxation, Territory of Alaska, the defendant, and to J. Gerald Williams, Attorney General of the Territory of Alaska, and John Dimond, Assistant Attorney General, Attorneys for defendant:

Greeting: You are hereby cited and admonished to be and appear in the United States Court of Appeals for the Ninth Circuit, to be holden in the city of San Francisco, State of California, or at such other place within the Ninth Circuit as may be designated by the Court, within forty days from the date of this Citation, pursuant to an Order allowing an Appeal made and entered in the above-entitled action on this day, in which Appeal the above-named plaintiff is the Appellant, and the above-named defendant is the Appellee, to show cause, if any there be, why the Judgment and Decree rendered in the above-numbered cause on the 8th day of July, 1949, in favor of the defendant and against the plaintiff, the Appellant herein, should not be corrected, set aside and reversed and why speedy justice should not be done to the plaintiff, the Appellant herein, in that behalf.

Witness the Hon. Fred M. Vinson, Chief Justice of the Supreme Court of the United States of America, on this 9th day of July, the year One

Thousand Nine Hundred and Forty-Nine, and of our independence, the One Hundred and Seventy-Third. [57]

Witness my hand and the seal of the above-named District Court on the 9th day of July, 1949.

/s/ GEORGE W. FOLTA,
District Judge.

Copy received this 9th day of July, 1949.

/s/ J. GERALD WILLIAMS,
Attorney General, Territory of Alaska,
Attorney for Defendant.

By /s/ JOHN H. DIMOND,
Of Counsel.

Filed July 9, 1949. [58]

[Title of District Court and Cause.]

STIPULATION RE PRINTING OF RECORD

It Is Hereby Stipulated by and between the parties above named, through their respective attorneys, that in printing the papers and records to be used in the hearing on appeal in the above entitled cause, before the U. S. Court of Appeals for the Ninth Circuit, the title of the court and cause in full shall be omitted from all papers except on the first page of the record and that there shall be inserted in place of the title on all papers used as a part of the record the words "Title of Court and

Cause''; also that all endorsements on all papers used as a part of the record may be omitted except the clerk's filing marks and admission of service.

Dated at Juneau, Alaska, the 9th day of July, 1949.

BOGLE, BOGLE & GATES,
FRANK L. MECHEM,
FAULKNER, BANFIELD & BOOCHEVER,
H. L. FAULKNER,
By /s/ H. L. FAULKNER
Attorneys for Plaintiff.
J. GERALD WILLIAMS,
Attorney for Defendant,
By /s/ JOHN H. DIMOND,
Of Counsel.

[Endorsed]: Filed July 9, 1949. [59]

In the District Court for the Territory of Alaska, Division Number One, at Juneau

No. 6069-A

ALASKA STEAMSHIP COMPANY, a corporation,

Plaintiff,

vs.

M. P. MULLANEY, Commissioner of Taxation, Territory of Alaska,

Defendant.

REPORTER'S TRANSCRIPT OF RECORD

Be It Remembered, that on the 22nd day of April, 1949, at 2:30 o'clock p.m., at Juneau, Alaska, the above-entitled cause came on for hearing, the Honorable George W. Folta, District Judge, presiding; the plaintiff appearing by H. L. Faulkner and Frank L. Mechem, of its attorneys; the defendant appearing in person and by John Dimond, Assistant Territorial Attorney General;

Whereupon, the following occurred:

Mr. Faulkner: Before we proceed to take the testimony of Mr. McCarthy I think perhaps the Attorney General will stipulate that the Alaska Steamship Company is a corporation authorized to do business in the Territory and has complied with all the laws and payment of corporation taxes and filed its reports to date.

Mr. Dimond: It is so stipulated. [61]

The Court: The record may show that it is so stipulated.

WILLIAM PAUL McCARTHY

called as a witness on behalf of the plaintiff, being first duly sworn, testified as follows:

Direct Examination

By Mr. Mechem:

Q. Will you state your full name?

A. William Paul McCarthy.

Q. What is your residence, Mr. McCarthy?

A. Seattle, Washington.

Q. And what is your occupation?

A. I am Assistant Treasurer and Auditor of the Alaska Steamship Company.

Q. You are, as I understand it, the Chief Auditor? A. That is correct.

Q. How long have you served in that capacity with the company? A. Four years.

Q. And you have been with the company for some time prior to that?

A. Twenty-three years.

Q. Will you describe the nature of your duties as Assistant Treasurer and Chief Auditor of the company with particular reference to payrolls and payroll taxes?

A. All records pertaining to payrolls and payroll taxes are [62] under my supervision, and any amounts withheld from the employees' payrolls, those records are also under my supervision.

Q. And does that include withholdings under the Federal Income Tax Law? A. It does.

Q. And does it include withholdings under the Alaska Income Tax Law? A. It does.

(Testimony of William Paul McCarthy.)

Q. Are you generally familiar, Mr. McCarthy, with all of the operations of the Alaska Steamship Company? A. I am.

Q. And let me ask you if you are the W. P. McCarthy who gave affidavits in support of the complaint filed by the Alaska Steamship Company in this matter? A. I am.

Q. Will you state the nature of the operations of the Alaska Steamship Company so far as it includes the Territory of Alaska, how they operate and where?

A. We operate—the Alaska Steamship Company operates vessels in interstate commerce from Seattle, Washington, to and from all principal ports in Alaska and within Alaska.

Q. And in addition to the principal ports do you operate to outports and canneries?

A. That is correct; when business warrants. [63]

Q. How many vessels does the company operate in the Alaska trade at the present time?

A. Twelve.

Q. And do you know how many seamen are employed by the company in that operation?

A. That would approximate 706.

Q. And do you know whether those seamen are residents or non-residents of the Territory of Alaska? A. They are non-residents.

Q. Based on the present operating schedules of the company, approximately how many sailings per week does the company have in the Alaska trade?

(Testimony of William Paul McCarthy.)

A. Presently that would approximate four sailings a week.

Q. That is four sailings from Seattle a week?

A. Yes, sir.

Q. And those are round-trip sailings, so that the vessels average four departures from Seattle each week and ultimately return to Seattle at the conclusion of the voyages? A. That is correct.

Q. Mr. McCarthy, have you made a study to determine what portion of the actual voyages of these vessels occur in the territorial waters of Alaska?

A. I have.

Q. And based upon your study, what percentage —I am just asking you for an average to cover all these things—what [64] percentage would you say it involves, operations within the territorial waters?

A. In my opinion it would amount to about 75%.

Q. Now, will you describe the method or the procedure followed by the Alaska Steamship Company in employing these seamen who operate these vessels in the Alaska trade; in other words, will you describe how they are employed and under what arrangements?

A. At the beginning of each voyage there is a contract between the seamen and the master of the vessels wherein it is agreed that the vessels will sail to certain areas in Alaskan waters and return to a United States port, and in these articles of agree-

(Testimony of William Paul McCarthy.)

ment there is stated the amount of wages that will be paid these individual seamen for their employment.

Q. And are those agreements entered into, or do you know, Mr. McCarthy, whether those agreements are entered into with the various unions to which these seamen belong, whether the contracts are negotiated on a union basis? A. They are.

Q. Now, when are the seamen paid off who are employed under these contracts which you have described?

A. They are paid off upon the termination of the vessel's voyage, which termination usually happens after the vessel's return to Seattle, Washington, and the cargo of the vessel [65] has been discharged.

Q. And in paying off the seamen, the vessel's personnel, what kind of arrangement do you have for the determining of the amount of wages and the amount of withholdings and so forth?

A. We give each individual seaman a statement of account, or a wage account, which shows among other things the total number of days that he is employed aboard the vessel or for the voyage and his overtime, the amounts he has earned in excess of the union agreements, and then from that total is deducted the applicable withholding for Federal Income Tax, and also Federal Old Age Benefit, and also the Alaska Net Income Tax.

Q. There was attached to your affidavit, Mr.

(Testimony of William Paul McCarthy.)

McCarthy, and marked Exhibit A, a copy of a wage statement form which was designated as "Seamen's Statement of Account." Is that the wage statement you have just referred to?

A. That is the one I described.

Mr. Mechem: At this time, if the Court please, I should like to offer the "Seaman's Statement of Account" which is attached to the witness' affidavit filed in support of the complaint. I should like to offer that in evidence at this time.

The Court: It may be admitted and marked Plaintiff's Exhibit No. 1. [66]

Clerk of Court: The exhibit has been marked Plaintiff's Exhibit No. 1.

Q. Mr. McCarthy, can you state whether the Alaska Steamship Company did withhold on account of Alaska Income Tax from the wages paid to seamen during the first quarter of 1949?

A. They did.

Q. And can you state the amount which was so withheld? A. $7,399.75.

Q. And can you state whether the company has continued to withhold on seamen's wages since the close of the first quarter of 1949?

A. The company has.

Q. And is it still withholding at the required rate upon seamen's voyage pay or wages at this time? A. Yes, sir.

Mr. Mechem: As it is material to the witness' testimony at this point, your Honor, I should like

(Testimony of William Paul McCarthy.)

to offer in evidence certified copies of two preliminary injunctions, an orginal and a supplemental preliminary injunction, issued by the United States District Court for the Western District of Washington—Northern Division, in the case of John E. Humes, Bob Dombroff and Sailors' Union of the Pacific against Alaska Steamship Company, being cause No. 2192. Certified copies of both of those orders were made a part of the complaint in this proceeding and are a part of the file in this Court. I should [67] like to offer them in evidence at this time.

The Court: Any objection?

Mr. Dimond: No objection.

The Court: They may be admitted and marked Plaintiff's Exhibits 2 and 3.

Q. Mr. McCarthy, are you familiar with the requirements of the two injunctions issued in the case of Humes, et al. against Alaska Steamship Company, to which I have just made reference and which have been admitted in evidence in this case?

A. I am.

Q. Will you state what those injunctions require the Alaska Steamship Company to do with respect to the amounts withheld from the voyage pay or wages of members of the Sailors' Union of the Pacific on account of Alaska Income Tax?

A. It requires that those withheld amounts be placed in a special fund in a depository and, further, that these funds cannot be withdrawn by the

(Testimony of William Paul McCarthy.)

company. It also restricts the company from paying over these withheld funds to the Territory of Alaska.

Q. So that at the present time if the company made any payment, of any of the amounts withheld, over to the Territory of Alaska, it would do so in violation of the terms of those injunctions?

A. That is correct. [68]

Q. Have the withheld amounts been placed in a special fund, and are they at the present deposited in a special fund, as provided by the two injunctions? A. They have been.

Q. Mr. McCarthy, what employees, if any, does the Alaska Steamship Company have in the Territory of Alaska aside from the seamen that we have been referring to?

A. They have agents and assistant agents and office employees.

Q. How many such employees, if you know, does the company have in the Territory?

A. Nineteen.

Q. And has the company been withholding upon their wages in accordance with the requirements of the Alaska Income Tax Law?

A. The company has.

Q. Are these employees residents of the Territory of Alaska or are they non-residents?

A. They would be considered residents.

Q. Now, does the Alaska Steamship Company have employees, other than the seamen to whom we

(Testimony of William Paul McCarthy.)

have referred and the nineteen resident employees in the Territory of Alaska, who may upon occasions perform services for the company in the Territory of Alaska? A. It has.

Q. And can you state whether those employees are residents or [69] non-residents of the Territory of Alaska?

A. They are non-residents.

Q. Do they mostly reside in Seattle, Mr. McCarthy? A. They do.

Q. Have any such employees performed services for the Alaska Steamship Company in the Territory of Alaska during the year 1949?

A. They have.

Q. Have any of them been here for substantial periods of time?

A. The most, I believe, would be about three to five weeks.

Q. And in your opinon are they likely to be required to spend substantial additional time in the Territory for the company for the year 1949?

A. I believe that they will be.

Q. Going back to the amount of $7,399.75, which you stated had been withheld for the first quarter of 1949 from seamen's wages on account of the Alaska Income Tax Law, what part of that $7,399.75 was withheld while the Act of January 22, 1949, sometimes referred to as the First Alaska Income Tax Law, was in effect, if you know?

A. All but approximately $125.00 of the $7,399.75.

(Testimony of William Paul McCarthy.)

Q. And the other $125.00 was withheld under the Act of March 26, 1949? A. It was.

Q. Now, going to the employees of the Alaska Steamship Company [70] other than the seamen —that is, the 19 resident employees in the Territory who are not seamen and the employees who are resident in Seattle who perform services in the Territory for the company—do you know the amount of Alaska Income Tax withheld from the wages of those employees during the first quarter of 1949?

A. I do.

Q. Would you state the amount please?

A. $2,319.96.

Q. How much of that amount was withheld under the Act of January 22, 1949?

A. All of it.

Q. Mr. McCarthy, it has been pointed out in the course of your testimony that the two injunctions, which were issued by the Federal District Court sitting in Seattle, were issued pursuant to an action brought by the Sailors' Union of the Pacific. Can you state and do you know the basis upon which the Alaska Steamship Company has withheld Alaska Income Tax from the voyage wages or voyage pay of seamen serving on the Alaska Steamship Company's vessels who are not members of the Sailors' Union of the Pacific?

A. That was by agreement of the various other unions and the legal department of the Alaska Steamship Company, because these other unions

(Testimony of William Paul McCarthy.)

threatened that they would instigate the same type of injunction that was issued in the Humes [71] case if this were not done.

Q. So that, as I understand you, the company was then left with no alternative other than to agree with the other unions that they would receive the same treatment, so far as the company is concerned, as the Sailors' Union of the Pacific reserved under the two injunctions issued by the Federal District Court in the suit brought by them?

A. That is correct.

Q. Do you know, Mr. McCarthy, whether the unions, the seamen's unions—I am speaking of them in the aggregate now, all of the unions to which these seamen belong, these 706 seamen—do you know whether those unions have made any threats to strike or to refuse to operate the company's vessels unless the company did certain things; do you know whether there were any such threats made?

A. I have heard that, but it has never been made to me.

Q. Now, the amounts which you have withheld on the wages of seamen other than members of the Sailors' Union of the Pacific, have they been placed in this same special fund that you referred to?

A. They have.

Q. Has the company received from the defendant in this action, the Commissioner of Taxation for the Territory of Alaska, any forms or instructions relative to the payment of these withheld amounts over to the Territory of Alaska? [72]

(Testimony of William Paul McCarthy.)

A. The company has.

Q. What, as you understand it, is the company required to do in that connection?

A. We are required to pay the amounts withheld for the first quarter of 1949 to the Tax Commissioner on or before April 30, 1949, the amounts withheld from the seamen's wages.

Q. And does that also require you to pay over to the Territory on or before April 30th the amounts withheld from the wages of company employees other than seamen? A. That is right.

Q. Has the company filed these returns?

A. No, sir.

Q. Has it paid over to the Territory any of the withheld tax on wages of its employees, including seamen? A. No, sir.

Q. Have you, Mr. McCarthy, had any occasion to examine the Alaska Income Tax Law for the purpose of ascertaining how the Alaska Steamship Company, as an operating company, would be required to determine its own income tax liability to the Territory of Alaska? A. I have.

Q. Does the Alaska Income Tax Law provide any method by which the Alaska Steamship Company could allocate its Federal Income Tax in such a manner that it would not be required to pay Alaska Income Tax based upon the entire amount of [73] its Federal Income Tax?

A. It does.

(Testimony of William Paul McCarthy.)

Q. That is what we refer to as the allocation formula of the Alaska Income Tax Law?

A. Yes.

The Court: I didn't quite get that previous question. What was that?

Court Reporter: "Does the Alaska Income Tax Law provide any method by which the Alaska Steamship Company could allocate its Federal Income Tax in such a manner that it would not be required to pay Alaska Income Tax based upon the entire amount of its Federal Income Tax?"

A. "It does."

Q. Have you made any attempt, Mr. McCarthy, to determine what percentage figure the allocation formula in the Alaska Income Tax Law would be applied against the Federal Income Tax of the Alaska Steamship Company in arriving at the tax base for the Alaska Steamship Company under the Alaska Income Tax Law?

A. I have made a study based on the 1948 operations of the company.

Q. And based upon those operations what percentage, according to the allocation formula in the Alaska Law, what percentage of the total amount of Federal Income Tax would be subject to the Alaska Income Tax?

A. Approximately 45%. [74]

Q. So that, as I understand you, to arrive at the amount of Alaska Income Tax which the company would be required to pay over to the Territory as

(Testimony of William Paul McCarthy.)

its own Territorial Income Tax, it would take 45% of its total Federal Income Tax and then pay to the Territory 10% of that amount?

A. That is correct.

Q. Is the Alaska Steamship Company, as far as you know, if you know, planning to continue to operate throughout the year 1949 as it is operating presently?

A. The company will operate more fully than it is at the present.

Q. That is to say, they will make more voyages, more trips in the territorial waters of Alaska?

A. We will operate more vessels and, naturally that would follow, there would be more voyages.

Mr. Mechem: That is all, your Honor.

Cross-Examination

By Mr. Dimond:

Q. Mr. McCarthy, do you have separate accounts distinguishing between operations in Alaska and "Outside," separate profit and loss statements?

A. No, sir.

Q. In other words, the 45% is determined by means of the allocation formula, from that? [75]

A. That is right.

Q. Mr. McCarthy, I don't remember whether you said—did you withhold the Alaska Income Tax from the wages of the employees who were temporarily in Alaska for four or five weeks?

A. I have.

(Testimony of William Paul McCarthy.)

Q. When the seamen sign articles of agreement with the company is there a contract between the seamen and the company as to withholding Federal Taxes?

A. No, sir. Of Federal Taxes, no; that is not mentioned in the contract.

Mr. Dimond: No more questions.

(Witness excused.)

Thereafter, on the 29th day of April, 1949, the following stipulation in writing was filed in the above-entitled cause:

"Stipulation Re Introduction of Evidence on Behalf of Plaintiff."

No. 6069-A

"It is hereby stipulated and agreed between the respective parties hereto acting through and by their attorneys, that the Canvassing Board of the Territory of Alaska, after the territorial election of October 8, 1946, and on December 19, 1946, issued certificates of election to those members of the House and the Senate of Alaska, who were elected at the October, 1946, election, certifying that they were elected [76] 'for the term beginning January 27, 1947'; and that on December 1, 1948, the same Canvassing Board issued certificates of election to those members of the House and Senate of Alaska who were elected on October 12, 1948, and that the certificates issued on December 1, 1948, to those

members who were elected in October, 1948, certified that they were elected to the legislature 'for a term of two years as provided by law, and four years as provided by law' respectively.

"Dated At Juneau, Alaska, April 28th, 1949."

BOGLE, BOGLE & GATES,
FAULKNER, BANFIELD
& BOOCHEVER,
Attorneys for Plaintiff.

(Filing stamp)

/s/ J. GERALD WILLIAMS,
Attorney General of Alaska,
Attorney for Defendant.

[Endorsed]: Filed July 9, 1949.

Thereafter, on the 5th day of May, 1949, at 10:00 o'clock, a.m., at Juneau, Alaska, the above-entitled cause came on for further hearing, the Honorable George W. Folta, District Judge, presiding; the plaintiff appearing by H. L. Faulkner and Frank L. Mechem, of its attorneys; the defendant appearing by J. Gerald Williams, Attorney General of Alaska, and John Dimond, Assistant Attorney General of Alaska;

Whereupon, the following occurred:

Mr. Faulkner: It is stipulated that the Extraordinary [77] Session of the Territorial Legislature called to meet on January 6, 1949, and which passed the Alaska Net Income Tax Law, Chapter 3 of the

Session Laws of the Extraordinary Session of 1949, was composed of those members of the Territorial House and Senate who were elected at the regular Territorial election in October, 1948; that the call for the Extraordinary Session was issued by the Governor on December 17, 1948, and it was issued and sent to the members of the House and Senate who had been elected at the October, 1948, election; that the certificates of the Secretary of Alaska certifying the names of the members of the House and Senate who met in Extraordinary Session on January 6, 1949, were issued by the Secretary of Alaska on December 22, 1948, and they contained the names of the members of the House and Senate respectively, who had been elected at the election held in October, 1948, and those, together with the holdover members of the Senate, were the members who composed the Extraordinary Session of the Legislature held from January 6, 1949, until and including January 22, 1949, and that they passed the Alaska Net Income Tax Law, which was approved on January 22, 1949. I understand that is stipulated?

Mr. Williams: It is so stipulated.

Mr. Faulkner: We have subpoenaed the Secretary of Alaska, and that will obviate the necessity of his testimony with the original records.

(End of Record.) [78]

United States of America,
Territory of Alaska—ss.

I, Mildred K. Maynard, Official Court Reporter for the hereinabove entitled court, do hereby certify:

That as such Official Court Reporter I reported the above-entitled cause, viz. Alaska Steamship Company, a corporation, Plaintiff, vs. M. P. Mullaney, Commissioner of Taxation, Territory of Alaska, Defendant, No. 6069-A of the files of said court;

That I reported said cause in shorthand and myself transcribed said shorthand notes and reduced the same to typewriting;

That the foregoing pages numbered 1 to 18, both inclusive, contain a true and correct transcript of all the testimony at the hearing of the above-entitled cause and the stipulations entered into between the respective parties on the dates hereinbefore specified, to the best of my ability.

Witness my signature this 9th day of July, 1949.

/s/ MILDRED K. MAYNARD,
Official Court Reporter,
U. S. District Court,
First Division, Territory of
Alaska. [79]

[Title of District Court and Cause.]

ORDER SETTLING AND ALLOWING THE BILL OF EXCEPTIONS

Be It Remembered that on this 9th day of July, 1949, the matter of settling the Bill of Exceptions in the above-entitled cause came on regularly for hearing and the Judge of the above-entitled Court being duly advised in the premises,

It Is Hereby Ordered, Adjudged and Certified as to the Bill of Exceptions, consisting of 19 pages, as follows, to wit:

a. That the Bill of Exceptions has been filed, allowed and certified within the time required by law, and the rules of this Court,

b. That it contains the complete transcript of testimony and evidence before the Court on the trial of this cause, including facts stipulated; that it sets forth the rulings of the Court upon all motions for introduction of evidence; all the oral and documentary evidence given upon the trial of the cause which is necessary to clearly present the questions of law involving the rulings to which errors were assigned in the Assignment of Errors heretofore filed in this cause,

c. That the Bill of Exceptions is hereby settled, allowed and cited as the true and correct Bill of Exceptions of all matters and things therein contained,

d. That the Bill of Exceptions is hereby made a part of the record of this cause,

e. That this Order constitutes the Judge's certificate to the Bill of Exceptions and that it be placed by the Clerk of this Court at the end of the Bill of Exceptions and attached to it as a part thereof.

Done in open Court this 9th day of July, 1949, at Juneau, Alaska.

/s/ GEO W. FOLTA,
District Judge.

Copy received this 9th day of July, 1949.

J. GERALD WILLIAMS,
Attorney General, Territory of Alaska, Attorney for Defendant.

By /s/ JOHN H. DIMOND,
Of Counsel.

[Endorsed]: Filed and Entered July 9, 1949. [80]

[Title of District Court and Cause.]

PRELIMINARY INJUNCTION PENDING APPEAL

This matter came on regularly before the Court upon plaintiff's application for continuance of Temporary Injunction pending appeal to the U. S. Court of Appeals, and Plaintiff being represented by its attorney, H. L. Faulkner, and defendant by J. Gerald Williams, Attorney General, and John Dimond, Assistant Attorney General of Alaska, and the Court having read and considered the application and petition of plaintiff for a Preliminary Injunction

pending the appeal, and having considered the records and files herein and the certified copy of the Temporary Injunction issued by the District Court of the Western District of Washington, Northern Division, on February 4, 1949, in the case of John H. Humes, Bob Dombroff and Sailors Union of the Pacific vs. Alaska Steamship Company, No. 2192, and the Supplemental Injunction issued by the Court on April 4, 1949, in which Preliminary Injunction and Supplemental Injunction, plaintiff is ordered to withhold the amount of the Alaska Income Tax from wages of its seamen and vessel personnel and place the withholdings in a separate fund to be designated "Alaska Withholding Fund" and by the terms of which Preliminary Injunction and Supplemental Injunction the plaintiff herein is enjoined from paying over to the defendant as Tax Commissioner of the Territory of Alaska any portion of the taxes withheld from its employees; and it appearing that the Preliminary Injunction and Supplemental Injunction heretofore mentioned are still in force. It further appearing that in the above-entitled cause pending in this court a judgment has been entered in favor of defendant and dissolving the Preliminary Injunction issued by this Court on April 28, and that plaintiff is left without any adequate remedy and will suffer irreparable injury pending the appeal of this cause to the U. S. Court of Appeals for the Ninth Circuit, unless protected by order of this Court,

It Is Ordered that M. P. Mullaney, Commis-

sioner of Taxation of the Territory of Alaska, the defendant herein, be and he is hereby temporarily enjoined from collecting or attempting to collect in any manner whatsoever amounts withheld by plaintiff from wages and salaries of its seamen employees as a tax under the provisions of the Alaska Net Income Tax Laws of January 22, 1949, and March 26, 1949, pending the final determination and final decision of the U. S. Court of Appeals upon the appeal of plaintiff from the judgment of this Court, and

It Is Further Ordered that plaintiff continue to collect the withholding taxes from its employees in accordance with the provisions of the Act of the Legislature of Alaska of March 26, 1949, known as the Alaska Net Income Tax Act and that pending the appeal the plaintiff pay all amounts of the tax on the wages of plaintiff's seamen employees and vessel personnel accruing under the provisions of the act of the Legislature of Alaska of March 26, 1949, into the Alaska Withholding Fund already established by the orders of the District Court of the Western District of Washington, Northern Division, hereinabove mentioned.

This injunction does not apply to tax on resident employees of plaintiff-appellant, and the Clerk is ordered to refund to the plaintiff, the amount of the tax heretofore paid him by plaintiff, and impounded under the provisions of the Temporary Injunction of April 28, 1949.

Done in open Court this 9th day of July, 1949.

/s/ GEO. W. FOLTA,
District Judge.

Copy received this 9th day of July, 1949.

/s/ J. GERALD WILLIAMS,
Attorney General, Territory of Alaska, Attorney for Defendant.

[Endorsed]: Filed July 9, 1949. [82]

[Title of District Court and Cause.]

PRAECIPE FOR TRANSCRIPT OF RECORD

To J. W. Leivers, Clerk of the Above-Entitled Court:

You will please prepare transcript of record in the above-entitled cause to be filed in the Office of the Clerk of the United States Court of Appeals for the Ninth Circuit, sitting at San Francisco, California, upon appeal heretofore perfected in the Court, and include therein the following described papers and records, to wit:

1. Plaintiff's Complaint for Injunction and other relief, and exhibits thereto.
2. Plaintiff's Supplemental Complaint and exhibits thereto.
3. Affidavits in support of Application for Preliminary Injunction.
4. Order to show cause.

5. Defendant's Answer.
6. Preliminary Injunction.
7. Plaintiff's Exhibits Nos. 1, 2 and 3.
8. Opinion of Court.
9. Findings of Fact and Conclusions of Law.
10. Judgment and Decree.
11. Petition for allowance of appeal.
12. Assignments of error.
13. Order allowing appeal and fixing cost bond.
14. Cost bond on appeal.
15. Citation.
16. Stipulation re printing of record. [83]
17. Bill of Exceptions.
18. Order settling Bill of Exceptions.
19. Preliminary Injunction pending appeal.
20. This Praecipe for Transcript of Record.
21. Order Correcting Conclusions of Law and Judgment and Decree.

This transcript is to be prepared as required by law and the rules and orders of this Court and of the United States Court of Appeals for the Ninth Circuit, and to be forwarded to the United States Court of Appeals for the Ninth Circuit at San Francisco, California, so that it will be docketed therein within the time required by law and the rules of the Court.

Dated at Juneau, Alaska, this 9th day of July, 1949.

BOGLE, BOGLE & GATES.
/s/ FRANK L. MECHEM.
FAULKNER, BANFIELD & BOOCHEVER.
/s/ H. L. FAULKNER,
Attorneys for Plaintiff-Appellant.

Copy received this 9th day of July, 1949.
J. GERALD WILLIAMS,
Attorney General of Alaska, Attorney for Defendant-Appellee.
By /s/ JOHN H. DIMOND,
Of Counsel.

[Endorsed]: Filed July 9, 1949. [84]

ORDER CORRECTING CONCLUSIONS OF LAW AND JUDGMENT AND DECREE

It having been called to the attention of the Court that the Conclusions of Law entered in this cause on July 8, 1949, are inconsistent with the Findings of Fact, and that the Judgment is accordingly inconsistent,

It Is Hereby Ordered that the Conclusions of Law contained in the Findings of Fact and Conclusions of Law entered on July 8, 1949, be corrected so that Conclusion of Law No. III read as follows:

"That Chapter 115, Session Laws of Alaska, 1949,

is a valid Act with the exception that the portions of Section 5-B (1) of Chapter 115 contained in the clause 'including the waters over the Continental Shelf' is indefinite, but under the severability clause contained in the Act its indefiniteness does not affect the validity of the remainder of the Act, and the Temporary Injunction granted herein on the 28th day of April, 1949, should be vacated and the Complaint dismissed."

And It Is Further Ordered that the Judgment and Decree be corrected accordingly so that the first paragraph on Page 2 thereof read as follows:

"Ordered, Adjudged and Decreed that Chapter 115, Session Laws of Alaska, 1949, is a valid Act with the exception of the phrase in Section 5-B (1), 'including the waters over the Continental Shelf,' which phrase is indefinite, but the inclusion of this phrase does not affect the remainder of the Act because of the provision of Section 15 thereof."

Done In Open Court this 9th day of July, 1949.

/s/ GEORGE W. FOLTA,
District Judge.

Filed and entered in the District Court, Territory of Alaska, 1st Division at Juneau, July 9, 1949.

CERTIFICATE

United States of America,
District of Alaska, Division No. 1—ss.

I, J. W. Leivers, Clerk of the District Court for the Territory of Alaska, First Division thereof, do

hereby certify that the foregoing and hereto attached 85 pages of typewritten matter, numbered from 1 to 85, both inclusive, constitute a full, true and complete copy, and the whole thereof, of the record prepared in accordance with the praecipe of the Appellant on file herein and made a part hereof, in Cause No. 6069-A, wherein the Alaska Steamship Company, a corporation, is Plaintiff-Appellant and M. P. Mullaney, Commissioner of Taxation, Territory of Alaska, is Defendant-Appellee, as the same appears of record and on file in my office; that said record is by virtue of an appeal and Citation issued in this cause and the return thereof in accordance therewith.

And I further certify that this transcript was prepared by me in my office, and that the cost of preparation, examination and certification amounting to Thirty Dollars and 50/100 has been paid to me by Counsel for Appellant.

In Witness Whereof, I have hereunto set my hand and the seal of the above-entitled court this 20th day of July, 1949.

J. W. LEIVERS,
Clerk of District Court,
[Seal] By /s/ P. D. E. McIVER,
Deputy.

[Endorsed]: No. 12298. United States Court of Appeals for the Ninth Circuit. Alaska Steamship Company, a corporation, Appellant, vs. M. P. Mullaney, Commissioner of Taxation, Territory of Alaska, Appellee. Transcript of Record. Appeal from the District Court for the Territory District of Alaska, Division Number One.

Filed July 22, 1949.

/s/ PAUL P. O'BRIEN,

Clerk of the United States Court of Appeals for the Ninth Circuit.

In the United States Court of Appeals for the Ninth Circuit

No. 12298

ALASKA STEAMSHIP COMPANY, a corporation,

Appellant,

vs.

M. P. MULLANEY, Commissioner of Taxation, Territory of Alaska,

Appellee.

STATEMENT OF POINTS RELIED ON AND DESIGNATION OF PARTS OF RECORD TO BE PRINTED.

Comes now the appellant above named and adopts the Assignments of Error as its Statement of Points to be relied on in the United States Court of Appeals, and prays that the whole of the record as filed and certified, be printed.

Dated at Juneau, Alaska, July 9, 1949.

BOGLE, BOGLE & GATES,
FRANK L. MECHEM,
FAULKNER, BANFIED
& BOOCHEVER,
H. L. FAULKNER,
By /s/ H. L. FAULKNER,
Attorneys for Appellant.

Docketed.

[Endorsed]: Filed July 26, 1949.

No. 12298

In The United States Court of Appeals

For the Ninth Circuit

ALASKA STEAMSHIP COMPANY, a Corporation
Appellant,

v.

M. P. MULLANEY, Commissioner of Taxation, Territory of Alaska,
Appellee.

Upon Appeal from the District Court for the Territory of Alaska, First Division

BRIEF FOR THE APPELLANT

BOGLE, BOGLE & GATES
FRANK L. MECHEM,
Central Building,
Seattle, Washington.

FAULKNER, BANFIELD & BOOCHEVER
H. L. FAULKNER,
Juneau, Alaska.

For Appellant.

No. 12298

In The United States
Court of Appeals
For the Ninth Circuit

ALASKA STEAMSHIP COMPANY, a Corporation
Appellant,

v.

M. P. MULLANEY, Commissioner of Taxation, Territory of Alaska,
Appellee.

Upon Appeal from the District Court for the Territory of Alaska, First Division

BRIEF FOR THE APPELLANT

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Frank L. Mechem,
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Faulkner, Banfield & Boochever
H. L. Faulkner,
Juneau, Alaska.

For Appellant.

INDEX

CITATIONS

CASES:

STATUTES:

MISCELLANEOUS:

NOTE:

The relevant portions of the principal statutes involved (Act of March 26, 1949, Chapter 115, Session Laws of Alaska, 1949; and Sections 3 and 9 of the Act of Aug. 24, 1912, c. 387, 37 Stat. 512 and 514) are set out in the Appendix.

In The United States
Court of Appeals
For the Ninth Circuit

No. 12298

ALASKA STEAMSHIP COMPANY, a Corporation
Appellant,

v.

M. P. MULLANEY, Commissioner of Taxation, Territory of Alaska,
Appellee.

Upon Appeal from the District Court for the Territory of Alaska, First Division

---

BRIEF FOR THE APPELLANT

OPINION BELOW

The opinion of the district court, as yet unreported, will be found at R. 44-60.

JURISDICTION

This is a suit to enjoin the appellee from enforcing the provisions of the Alaska Net Income Tax Act against appellant; to have declared invalid the provisions of the Act requiring appellant to withhold for income tax purposes upon the wages of its employees, including seamen; and to have declared invalid the Act in its entirety. Judgment and decree

was entered on July 8, 1949, sustaining the validity of the Act with certain exceptions, vacating a preliminary injunction and dismissing the complaint (R. 68). Petition for allowance of appeal was filed July 9, 1949, and order allowing appeal was signed July 9, 1949 (R. 70, 75). The jurisdiction of the district court was invoked under the Act of June 6, 1900, c. 786, §4, 31 Stat. 322, as amended, 48 U. S. C. A. §101. The jurisdiction of this court rests on §1291 of the New Federal Judicial Code.

QUESTIONS PRESENTED

1. Whether Chapter 115, Session Laws of Alaska, 1949, known as the Alaska Net Income Tax Act, imposing a net income tax, is a valid exercise of the taxing authority of the Territory.

2. Whether, if some provisions of the Alaska Net Income Tax Act are invalid, the remainder of the Act may be given effect.

SPECIFICATIONS OF ERROR

The assignments of error (R. 71) may be summarized as follows:

1. The court erred in finding that section 16 of chapter 115, Session Laws of Alaska, 1949, ratified and confirmed the withholdings of income taxes made pursuant to chapter 3 of the Laws of the Extraordinary Session, Alaska, 1949.

2. The court erred in finding that the term "continental shelf" as used in section 5-B (1) of chapter 115, Session Laws of Alaska, 1949, in the clause "including the waters over the continental shelf" may, under the severability provision of section 15

of the Act, be eliminated without affecting the remainder of the Act.

3. The court erred in its conclusion that the income tax withholdings made pursuant to chapter 3 of the Laws of the Extraordinary Session, Alaska, 1949, are valid under the provisions of section 16, chapter 115, Session Laws of Alaska, 1949.

4. The court erred in its conclusion that chapter 115, Session Laws of Alaska, 1949, is a valid Act.

5. The court erred in giving and entering an order, judgment and decree in favor of defendant and against plaintiff that chapter 115, Session Laws of Alaska, 1949, is a valid act, vacating the preliminary injunction granted by the court on April 28, 1949, and dismissing plaintiff's complaint.

STATEMENT

This action was instituted by appellant, a Washington corporation, on April 8, 1949, to enjoin the enforcement of chapter 115, Session Laws of Alaska, 1949, imposing a net income tax; to have declared invalid the provisions of the Act requiring appellant to withhold for income tax purposes upon the wages of its employees, including seamen; and to have declared invalid the Act in its entirety. (R. 2-36).

On January 22, 1949, an Extraordinary Session of the Alaska legislature enacted a net income tax law entitled Alaska Net Income Tax Act. This session was called by the Governor on January 6, 1949, and was composed in part of members elected at the general election in October, 1948, although the Organic Act for Alaska (Act of Aug. 24, 1912, c. 387, §1, 37 Stat. 512, 48 U. S. C. A. §21, *et seq.*) provides, in effect,

that each new legislature shall be constituted on, and convene, the fourth Monday in January in every odd-numbered year. Because of doubt respecting the validity of that session, subsequently, on March 26, 1949, at the regular session of the legislature the law was reenacted as chapter 115, Session Laws of Alaska, 1949, with certain changes which will later be noted, and this Act expressly repealed the Act of January 22, 1949, but by section 16 purported to ratify and confirm all administrative steps purported to be taken pursuant to the earlier Act and all withholdings of income tax from the wages of employees which were required to be made by the earlier Act.

Appellant is engaged in the operation of a line of vessels transporting freight and passengers between Seattle, Washington, and ports in Alaska in interstate commerce, including such outports as salmon canneries located in the Territory. In this trade appellant was operating 12 vessels, manned by 706 seamen, who were nonresidents of Alaska, at the time this case was tried, with an operating schedule of four sailings a week from the Port of Seattle to the Territory of Alaska. Additional ships, sailings and seamen are scheduled during the summer months. Approximately 75% of the elapsed time on the voyages of appellant's vessels is spent in the territorial waters of Alaska and in waters off-shore from the coast of Alaska but outside of the territorial waters (R. 84, 85).

The vessel personnel are members of various unions, including the Sailors' Union of the Pacific, and all seamen serving on vessels of appellant, including all

deck crews, are employed under union contracts and are paid off in Seattle at the end of each voyage, payment being computed according to the union scale and the union contract (R. 85, 86).

Immediately after the enactment of the Act of January 22, 1949 (the first Alaska Net Income Tax Act), appellant began withholding income taxes from the wages paid to all of its employees who performed services in Alaska, in accordance with the withholding requirements of the Act. This included withholdings with respect to vessel personnel, 19 resident Alaska employees, and some Seattle resident shore employees who made extended trips to the Territory on company business (R. 87).

Deeming themselves aggrieved by these withholdings, the employee members of the Sailors' Union of the Pacific on February 4, 1949, obtained an injunction from the United States District Court for the Western District of Washington, Northern Division, in the case of *John E. Humes, Bob Dombroff et al and Sailors' Union of the Pacific v. Alaska Steamship Company,* No. 2192, which ordered appellant to withhold the Alaska income tax from the wages of its seamen and to place the amount so withheld in a special fund, subject to the order of that court, and which enjoined appellant from paying any portion thereof over to appellee as Tax Commissioner of the Territory of Alaska (R. 10). Subsequently, on April 4, 1949, that court issued a supplemental order in the *Humes* case which extended the original injunction to the Act of March 26, 1949 (chapter 115, Session Laws of Alaska, 1949) (R. 24).

Confronted with the demand of appellee for payment of the withholding tax and the injunction restraining such payment with respect to the Sailors' Union members, appellant brought this action to test the validity of the Act, including the withholding requirements. In a preliminary injunction issued on April 28, 1949, the court enjoined defendant from collecting any withholding taxes from appellant and ordered the appellant to withhold the required amount of income taxes from the wages of its Alaska resident shore employees and pay the same into court pending further order of the court (R. 42). For the first quarter, 1949, the amounts withheld and paid into the Washington and Alaska special funds were $7,399.75 and $2,319.96 respectively (R. 87, 91).

Thereafter, trial was had on May 5, 1949, at which time plaintiff introduced evidence and testimony in support of its complaint and defendant introduced none (R. 82-96). On June 24, 1949, the court issued an opinion holding that the Act of March 26, 1949 (chapter 115, Session Laws of Alaska, 1949) was valid in its entirety, except (1) that the term "continental shelf" as used in section 5-B(1) was too indefinite to be given effect, but that pursuant to the severability clause of section 15 it could be eliminated without affecting the remainder of the Act, and, (2) that the Extraordinary Session of the legislature was invalid because not authorized by law, but that everything done or required to be done by the Act of January 22, 1949, was validated by section 16 of the Act of March 26, 1949 (R. 44-60).

Findings of fact and conclusions of law were filed

in accordance with the court's opinion (R. 61-67), and on July 8, 1949, a judgment and decree was entered sustaining the validity of the Act with the exceptions noted, and vacating the preliminary injunction and dismissing plaintiff's complaint (R. 68). This appeal followed (R. 70).

SUMMARY OF ARGUMENT

I.

The wages of seamen and vessel personnel are not subject to withholding of income taxes imposed by state or local law. *A fortiori* they are not subject to such withholding imposed by territorial law. *American-Hawaiian Steamship Company v. Fisher,* 89 F. Supp. 193 (1949). Cf. *Calmar Steamship Co. v. Taylor,* 303 U. S. 525 (1938); *Shilman v. U. S.,* 164 F. 2d 649 (1948).

II.

The Alaska Net Income Tax Act purports to impose an income tax upon both residents, and, nonresidents deriving income from Alaska sources, the tax to be computed at the rate of 10% of the taxpayer's Federal income tax or withholding tax. Certain allocation features are provided and withholding is required with respect to the wages of all persons having no other income from Alaska sources. Detailed administrative provisions for the collection, refunding and determination of taxes and of tax controversies are included. The question presented by this part of the appeal is, therefore, whether any of the provisions of the Act are invalid, and if so, whether such invalidity affects the Act as a whole.

A. The Act incorporates by reference the Internal Revenue Code (Act of Feb. 10, 1939, c. 2, 53 Stat. 1, 26 U. S. C. A., §1, *et seq.*) and various regulations of the Commissioner of Internal Revenue "as now in effect *or hereafter amended.*" (Italics supplied.) This is an attempted delegation of legislative authority to Congress and to the Commissioner of Internal Revenue which renders the entire Act invalid. *State v. Webber,* 125 Me. 319, 133 A. 738 (1926); *Florida Industrial Commission v. State,* 155 Fla. 772, 21 So. 2d 599 (1945); *State v. Intoxicating Liquors,* 121 Me. 438, 117 A. 588 (1922); Cf. *Panama Refining Co. v. Ryan,* 293 U. S. 388 (1934).

B. The Organic Act for Alaska (Act of Aug. 24, 1912, c. 387, §1, 37 Stat. 512, 48 U. S. C. A., §21 *et seq.*) requires that "all taxes shall be uniform upon the same class of subjects"; the Fourteenth Amendment of the Federal Constitution guarantees to all persons due process and the equal protection of the laws; and the Civil Rights Act (Act of May 31, 1870, c. 114, §16, 116 Stat. 144, 8 U. S. C. A., §41) similarly provides that all persons within the jurisdiction of the United States, "in every State and Territory," shall be subject to "like punishment, pains, penalties, taxes, licenses and exactions of every kind, and to no other." The Alaska Act results in inequalities and discriminations which violate each of these limitations.

C. Although a fairly wide latitude is permitted a legislature in classifying persons for purposes of taxation, where such classifications are arbitrary or unreasonable the statute is invalid. *Toomer v. Witsell,*

333 U. S. 848 (1948); *Colgate v. Harvey,* 296 U. S. 404 (1935); *Madden v. Kentucky,* 309 U. S. 83 (1940). In classifying, both for the purpose of the withholding tax and the direct tax, the allocation formulae discriminate in favor of one as against another of the same class without substantial basis. Such discriminations make the Act invalid. *Toomer v. Witsell, supra; F. S. Royster Guano Co. v. Virginia,* 253 U. S. 412 (1919). By the same allocation formulae the Act seeks to tax income of nonresidents and foreign corporations derived from sources beyond the taxing jurisdiction of the Territory.

D. The Act makes payment of the tax a condition to carrying on interstate commerce and is for that reason invalid. *Memphis Natural Gas Co. v. Stone,* 335 U. S. 80 (1948); *Underwood Typewriter Co. v. Chamberlain,* 254 U. S. 1131 (1920).

E. Section 7-D of the Act attempts to delegate to the Tax Commissioner certain authority to prescribe statutes of limitations and to make other determinations which are strictly legislative or judicial in character and not subject to delegation. *Schechter Poultry Corp. v. U. S.,* 295 U. S. 495 (1934).

F. Certain basic terms used in the Act are not defined and are so vague and indefinite that the Act cannot be given effect. *State v. Humble Pipe Line Co.,* 112 Tex. 375, 247 S. W. 1082 (1923).

III.

Where parts of a statute are inseparably connected with each other the invalidity of one part makes the entire statute invalid. The Alaska Act is an integrated taxing statute and the invalidity of any one or more

of the parts makes the Act void. 59 C. J. 641, fn. 15, Cf. *Pollock v. Farmers Loan & Trust Co.,* 157 U. S. 429 (1894).

IV.

The Act of March 26, 1949, purporting to repeal the Act of January 22, 1949, and to ratify and confirm the withholdings of income taxes made pursuant to the latter Act did not, as a matter of law, validate the taxes so withheld. The session of the legislature which enacted the Act of January 22, 1949, having been declared invalid its actions were void and in legal effect as if no such action had ever been taken. Such invalid action cannot be preserved by reference in a statute subsequently enacted at the regular session of the legislature.

V.

The court having properly assumed jurisdiction of the cause should observe the settled rule of equity and determine all questions which are material to the controversy and necessary to afford complete relief. *Allen v. Regents of the University System of Georgia,* 304 U. S. 439 (1938); *Alexander v. Hillman,* 296 U. S. 222 (1935).

ARGUMENT

Appellant's position is that the Alaska Net Income Tax Act is invalid as applied to its employees, whether seamen or shore workers, and cannot, therefore, furnish any basis for requiring appellant to withhold and pay over income taxes from the wages of those employees. As to appellant's shore workers it is submitted that if the Act is invalid for any reason it is

a complete defense to appellee's demand for payment of the withholding tax. An additional ground is available to appellant for resisting payment of the withholding tax on the wages of its seamen. *American-Hawaiian Steamship Company v. Fisher, supra.* The court having properly assumed jurisdiction of the cause should observe the settled rule of equity and determine all questions which are material to the controversy and necessary to afford complete relief. *Allen v. Regents of the University System of Georgia, supra; Alexander v. Hillman, supra.* There are several reasons why the Act is invalid and these will be discussed separately.

I.

THE WITHHOLDING TAX PROVISIONS OF CHAPTER 115, SESSION LAWS OF ALASKA, 1949, ARE INVALID AS APPLIED TO SEAMEN.

Section 5-B of the Act, like the same section of the original Act of January 22, 1949, imposed upon each seaman employed by appellant in the Alaska trade a tax equal to 10% of the tax deducted and withheld for Federal income tax purposes, and together with section 8 of the Act requires appellant to withhold such amounts from wages payable to its seamen and pay them over to appellee upon a quarterly basis. In this respect the Act is clearly invalid.

Section 3 of the Organic Act for Alaska provides that the Constitution of the United States and all laws thereof which are not locally inapplicable, shall have the same force and effect within the Territory as elsewhere in the United States. This definitely fixes the Federal Constitution as the Constitution for

the Territory of Alaska and requires that all laws enacted by the Territorial legislature shall be tested against that Constitution in determining their validity. *Haavik v. Alaska Packers Association,* 263 U. S. 510 (1923).

In addition, however, the Organic Act itself provides numerous limitations upon the legislative powers of the Territory with the result that the validity of any act of the legislature must also be tested against the Organic Act, as amended, as well as against the Federal Constitution. *Haavik v. Alaska Packers Association, supra.*

Also, the acts of the Territorial legislature must be tested against the aggregate of Congressional enactments to determine whether or not they are in such conflict with Acts of Congress as to be necessarily invalid for that reason. *Auk Bay Salmon Co. v. U. S.,* 300 Fed. 907 (1924).

In the Act of June 7, 1872, c. 322, §32, 17 Stat. 268, as amended, Title 46 U. S. C. A. §591-605, §682-685, Congress has adopted a comprehensive code of laws covering seamen's wages, including permissible deductions therefrom, and in so doing has completely occupied the field of deductions with the result that there remains to the states and territories no area of legislation in this respect. As the court said in the *American-Hawaiian Steamship Company* case:

> "46 U. S. C. A. § 591-605, §682-685, are laws of the United States enacted pursuant to Article III, Section 2, Clause 1 and Article I, Section 8, Clause 3 of the Constitution of the United States and prescribe the manner in which the wages of

seamen shall be paid by employers and specify that no deductions shall be made from the wages of seamen except as authorized by Federal law. Said provisions are laws of the United States enacted under and pursuant to the Constitution as aforesaid to provide a uniform system of law with respect to the wages of seamen. In particular, 46 U. S. C. A. §601, prohibits the attachment of the wages of seamen and provides that every payment of wages to a seaman shall be valid, notwithstanding any previous sale or assignment thereof or any attachment, encumbrance or arrestment thereon. Said provisions of the laws of the United States are the supreme law of the land pursuant to Clause 2, Article VI of the Constitution of the United States."

In that case the court held that the withholding tax requirement of the Oregon income tax law, as applied to seamen, was in operation and effect an attachment of the wages of the seamen contrary to 46 U. S. C. A. §601, and, accordingly, that the withholding tax requirement could not be enforced against seamen. Other cases furnish strong support for this view. *Calmar Steamship Co. v. Taylor, supra; Shilman v. U. S., supra.* And in any event it must be recognized that Congress, in the interests of uniformity, has preempted the field of deductions from seamen's wages and that only Congress can authorize deductions for income tax purposes. That Congress has not done so may not be urged as a reason for permitting states and territories to so legislate. Doubtless Congress is fully aware of the undesirable consequences which would flow from authorizing every

state and territory in which seamen perform any services to impose tax withholding requirements upon their wages. Here, absence of express consent by Congress is fatal to the attempt of the Territory to require withholding by appellant. *Napier v. Atlantic Coast Line R. Co.,* 272 U. S. 605 (1926); *LaCrosse Telephone Co. v. Wisconsin Unemp. Board,* 336 U. S. 18 (1949).

II.

CHAPTER 115, SESSION LAWS OF ALASKA, 1949, IS INVALID IN ITS ENTIRETY AND THEREFORE NECESSARILY INVALID AS TO SEAMEN.

A. The Act Is Invalid Because it Attempts to Delegate Legislative Functions.

Section 3-A(8) of the Alaska Net Income Tax Act defines the words "Internal Revenue Code" to mean "The Internal Revenue Code of the United States (53 Stat. 1) as amended *or hereafter amended.*" Section 3-B(1) provides that "Whenever the Internal Revenue Code is mentioned in this Act, the particular portions or provisions thereof, as now in effect *or hereafter amended,* which are referred to, shall be regarded as incorporated in this Act by such reference and shall have effect as though fully set forth herein," and Section 3-B(2) states that "Whenever any portion of the Internal Revenue Code incorporated by reference as provided in Paragraph (1) of this subsection refers to rules and regulations promulgated by the United States Commissioner of Internal Revenue, *or hereafter so promulgated,* they shall be regarded as regulations promulgated by the Tax Commissioner under and in accord with the pro-

visions of this Act, unless and until the Tax Commissioner promulgates specific regulations in lieu thereof conformable with this Act." (Italics supplied.)

Section 5 of the statute imposes two distinct and separate taxes. The first, imposed by section 5-A is levied upon the aggregate of all individuals, fiduciaries, corporations and banks with the exception of employees having no income from sources within Alaska other than wages or salary. Such employees are subjected to tax by section 5-B to which reference has previously been made.

Both of the taxes imposed by Section 5 of the Act are expressed in terms of a percentage of the income tax shown upon the taxpayer's Federal return in the first instance. Section 7, Act. That is the starting point in the computation of the Alaska tax. However, Section 5, imposing the taxes, expressly states that the tax shall be 10% of the total Federal income tax (or an allocated portion thereof) payable for the same taxable year under the provisions of the Internal Revenue Code.

Bearing in mind the definition of "Internal Revenue Code" quoted above Section 5 in its entirety is clearly invalid as an attempt to delegate functions which are exclusively those of the legislature and which cannot validly be delegated to any other body. Thus, it has been held that a state income tax law imposing a tax equal to 33 1/3% of the Federal income tax imposed by the United States Income Tax Act of November 23, 1921, and acts amendatory thereto *"which have been passed and approved prior to the time of the approval of this act,"* does not con-

stitute an invalid attempt at legislative delegation because the measuring stick incorporated into the state income tax law by reference was a fixed and known measure at the time the state law was enacted. (Italics supplied) *Santee Mills v. Query,* 122 S. C. 158, 115 S. E. 202 (1922). The opinion of the court shows that the statute would have been invalid if it had embraced future amendments to the Federal income tax law because it would then have delegated to Congress the function of determining the income tax law of the state. To the same effect, see *Featherstone v. Norman,* 170 Ga. 370, 153 S. E. 58 (1930). Other cases holding invalid any attempt to incorporate by reference future revisions or enactments by Congress, but involving subjects other than taxation, are *State v. Intoxicating Liquors,* 121 Me. 438, 117 A. 588 (1922); *State v. Webber,* 125 Me. 319, 133 A. 738 (1926); and *Florida Industrial Commission v. State,* 155 Fla. 772, 21 So. 2d 599 (1945).[1] Cf. 11 Am. Jur. sec. 219.

The court apparently believed that the attempted incorporation by reference of the Internal Revenue Code and the Commissioners' regulations "as hereafter amended" did not constitute an attempt to dele-

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[1] *State v. Intoxicating Liquors; State v. Weber:*

These cases involved prohibition laws enacted by the legislature of the state of Maine just prior to the Volstead Act. In the first case the Maine statute provided that intoxicating liquor should constitute "any beverage containing a percentage of alcohol, which by federal enactment * * * now or hereafter declared, renders a beverage intoxicating." The second case reaffirmed the holding in the first case that the attempt to delegate was invalid.

Florida Industrial Commission v. State:

This case invloved an attempt by the Florida legislature to incorporate by reference future acts of Congress affecting labor relations. The attempt to so delegate was held invalid.

gate legislative functions although frankly conceding that the cases cited by plaintiff supported its contention. (R. 52). We think there are no cases to be found to the contrary. *Ex parte Lasswell,* 1 Cal. App. 2d. 183, 36 P. 2d 678 (1934) cited by the Court (R. 53) as authority for the validity of the attempted delegation is, upon analysis, quite obviously in accord with all of the other cases dealing with this question. In that case the court found that the California Recovery Act by adopting the National Recovery Act for the State of California had established a primary standard and held that the further provision making the codes adopted by the Federal authorities become automatically the California codes did not constitute an invalid attempt to delegate legislative functions. The discussion of the question by that court makes it abundantly clear that it would have held invalid such attempted delegations as those involved in the present appeal.

The further comment by the court below (R 53) that plaintiff cannot avail itself of the objection of delegation because it was not shown that there had been any amendment of either Federal law or regulations since the enactment of the Act flies directly in the face of the decided cases above cited. It is the attempt to delegate that makes the Act invalid. *Panama Refining Co. v. Ryan,* 293 U. S. 388 (1934); *Smithburger v. Banning,* 129 Neb. 651, 262 N. W. 492 (1935). The latter case involves the precise point and the court held that the validity of the law did not depend on what had been done under it, but upon what the act purported to authorize. Moreover, it involved

a state statute which attempted to incorporate by reference future acts of Congress, and the statute was held to be invalid for that reason. As the court said in *State v. Intoxicating Liquors,* supra, "such legislation constitutes an unlawful delegation of legislative power, and an abdication by the representatives of the people of their power, privilege and duty to enact laws. The authorities are so unanimous on the question that extended citation is unnecessary."

B. The Act Is Invalid Because it Fails to Provide the Uniformity and Equality Demanded by the Organic Act, the Fourteenth Amendment and the Civil Rights Act.

Tax laws enacted by territorial legislatures are subject to a good many limitations, some of which are found in the Federal Constitution and some in acts of Congress. The impression which seems to have grown up in some quarters that a territorial legislature is free to legislate as it sees fit without regard to such limitations and restricted only by what it deems to be expedient, rests upon a complete misconception of the basic laws under which territorial governments function. Thus, section 9 of the Organic Act requiring that "all taxes shall be uniform upon the same class of subjects," the due process and equal protection clauses of the Fourteenth amendment and the guaranties of the Civil Rights Act are all limitations upon the taxing power of the Alaska legislature. *Auk Bay Salmon Co. v. U. S.,* supra.

Two cases are cited by the court for the proposition that the Fourteenth amendment does not apply to territories. *South Puerto Rico Sugar Co. v. Buscaglia,* 154 F. 2d 96 (1946); *Anderson v. Scholes,* 83 F. Supp.

681 (1949)[2]. The first case cites no authority for its conclusion and the second one relies upon cases involving unorganized territories having no local legislatures. On the other hand, this Court has recognized without discussion that the amendment is a limitation upon the legislative powers of an organized territory. *W. C. Peacock & Co. v. Pratt,* 121 F. 772 (1903). Cf. *Johnson v. Kennecott Copper Corp.,* 5 Alaska 571 (1916).

That organized territories, aspiring to statehood, and engaged in the structure of fiscal programs to facilitate the achievement of that objective should be subject to at least the same limitations in the exercise of the taxing power as states only makes common sense. Congress recognized this fact at an early date. In reenacting the Civil Rights Act immediately after the adoption of the Fourteenth Amendment Congress expressly extended its limitations to territories. 8 U. S. C. A. § 41. That statute provides:

> "All persons within the jurisdiction of the United States shall have the same right in every State and Territory to make and enforce contracts, to sue, be parties, give evidence, and to the full and equal benefit of all laws and proceedings for the security of persons and property as is enjoyed by white citizens, and shall be subject to like pun-

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[2] *South Puerto Rico Sugar Co. v. Buscaglia:*

This case involved a statute imposing a higher income tax on foreign corporations than upon domestic corporations. The statute was held to be valid.

Anderson v. Scholes:

This case involved a territorial statute providing for service of process upon non-residents. The statute was held invalid under the Fifth Amendment and the privileges and immunities clause of Article IV, §2, Federal Constitution.

ishment, pains, penalties, taxes, licenses, and exactions of every kind, and to no other."

The decisions in cases arising under the Civil Rights Act are unanimous in the view that it extends to all persons in every state and territory at least all of the protections guaranteed by the Fourteenth Amendment. In *County of San Mateo v. Southern Pacific Railway Co.,* 13 F. 145 (1882) Judge Field said:

> "Equality of protection is thus made the constitutional right of every person; and this equality of protection implies not only that the same legal remedies shall be afforded to him for the prevention or redress of wrongs and the enforcement of rights, but also that he shall be subjected to no greater burdens or charges than such as are equally imposed upon all others under like circumstances. No one can, therefore, be arbitrarily taxed upon his property at a different rate from that imposed upon similar property of others, similarly situated, and thus made to bear an unequal share of the public burdens. Property may indeed be classified, and different kinds be subjected to different rates. Real property may be taxed at one rate and personal property at another. Property in particular places may be taxed for local purposes, while property situated elsewhere is exempt. License taxes may also vary in amount according to the calling or business for which they are exacted. But arbitrary distinctions not arising from real differences in the character or situation of the property, or which do not operate alike upon all property of the same kind similarly situated, are forbidden by the amendment. Equality in the imposition of burdens is

> the constitutional rule as applied to the property of individuals, where it is subject to taxation at all; and this imports that an uniform mode shall be followed in the estimate of its value, and that the contribution exacted shall be in some uniform proportion to such value prescribed, according to the nature or position of the property. All state action, constitutional or legislative, impinging upon the enforcement of this rule, must give way before it. Congress, in its legislation since the adoption of the amendment, has recognized this to be the rule. The amendment was adopted in 1868, and in 1870 congress re-enacted the civil-rights act; and to the clause that all persons within the jurisdiction of the United States should enjoy the same rights as white citizens, and be subject only to like punishment, pains, and penalties, it added; and be subject only to like *'taxes, licenses, and exactions of every kind, and to no other.'* Rev. St. § 1977."

Accord: *Kentucky v. Powers,* 139 F. 452 (1905); *Murphy v. Ramsey,* 114 U. S. 15 (1885) (involving inhabitants of territories and recognizing the equal application of the statute to territories); *Strauder v. West Virginia,* 100 U. S. 303 (1879); *Holden v. Hardy,* 169 U. S. 366 (1897); *Hurd v. Hodge,* 334 U. S. 24 (1948).

Indeed, it may well be urged that the broad language of that statute effects a greater restriction upon the taxing power than does the amendment. Cf. *Takahashi v. Fish & Game Commission,* 333 U. S. 854 (1948). Apparently this statute was completely over-

looked in the *South Puerto Rico Sugar Co.* and *Anderson* cases.[3]

Measured by these limitations the Alaska Act cannot stand. To begin with, the Act is invalid because the legislature had no authority to enact a graduated net income tax law. The requirement of uniformity contained in the Organic Act is analogous to the equality and uniformity provisions of state constitutions. 51 Am. Jur. sec. 62. Against such requirements state graduated net income tax laws have been held invalid because they failed to achieve uniformity. *Bachrach, et al. v. Nelson, et al.,* 349 Ill. 579, 182 N. E. 909 (1932); *Kelley v. Kalodener,* 320 Penn. 180, 181 A. 598 (1935); *Culliton v. Chase,* 174 Wash. 363, 25 P. 2d 81 (1933); *Jensen v. Henneford,* 185 Wash. 209, 53 P. 2d 607 (1936); *In Re Opinion of Justices,* 266 Mass. 583, 165 N. E. 900 (1929). These cases hold that income taxes are taxes upon property and that regardless of the theoretical merits of a graduated net income tax law it is impossible to achieve uniformity in such a law. In *Pollock v. Farmers' Loan & Trust Co.,* 157 U. S. 429 (1894) the court also held that a net income tax is a tax upon property and there is nothing in subsequent decisions of the court modifying or weakening that view.

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3 Of course, the Fifth Amendment also applies to territorial legislation and, for the purposes of the challenge made to the validity of the Alaska Act in this brief, the due process clause of that amendment imposes substantially the same limitations as the Fourteenth Amendment. And as the court spelled it out in *Anderson v. Scholes, supra,* since the Fifth amendment and the privileges and immunities clause of Article IV, §2 are both applicable to enactments by the territorial legislatures, the net result is to impose limitations which include all of the area covered by the Fourteenth amendment.

The device of making the Alaska tax a flat percentage of the Federal income tax does not cure this defect because the latter is itself a graduated net income tax.

There is, however, still another ground upon which the Alaska Act violates the uniformity and equality requirements of the Organic Act, the Fourteenth amendment and the Civil Rights Act. This ground is one which appears from the face of the Act and which, therefore, the court may appropriately consider in an action testing the validity of the statute as a whole. Attention is again invited to the fact that if the Alaska Act is invalid for any reason then it is necessarily invalid with respect to the withholding requirements and appellant is, therefore, directly affected in this case by anything which is determinative of the validity of the Act. Appellant's position is neither hypothetical nor speculative when confronted with an injunction on the one hand and a demand for payment on the other. (R. 88, 91, 92)

Against this background it is submitted that the Act is invalid because it fails to take into account the fact that many taxpayers had unused net operating loss deductions under section 122 of the Internal Revenue Code for the years 1947 or 1948 which they are privileged to carry forward to their 1949 Federal income tax computation, and which when carried forward will wipe out their entire Federal net income and income tax for 1949 although they actually realize very substantial net income for that year. Compared with taxpayers having no net operating losses for these earlier years there is a complete failure of uniform-

ity and equality so far as the Alaska Act is concerned. Stated differently, the Alaska Act cannot possibly achieve uniformity and equality among taxpayers now for the first time subjected to tax by it because no adjustment is provided for eliminating the effect of the unused net operating loss carry-over provision of the Internal Revenue Code which relates to facts and circumstances occurring long prior to the effective date of the Act.

A similar result follows from the effect of the unused capital loss carry-over provided for by section 117 of the Internal Revenue Code.

Discriminations of this kind in favor of one as against another of the same class are not permitted under such requirements of uniformity and equality and state income tax laws which provide for or result in such forbidden discriminations have been held invalid. *F. S. Royster Guano Co. v. Virginia,* 253 U. S. 412 (1919); *Colgate v. Harvey,* 296 U. S. 404 (1935); *Madden v. Kentucky,* 309 U. S. 83 (1940); *Montgomery Ward & Co. v. Tax Commission,* 151 Kan. 159, 98 P. 2d 143 (1940). Cf. *Foster v. Pryor,* 189 U. S. 325 (1902); *Kentucky Union Co. v. Kentucky,* 219 U. S. 140 (1910); *Hillsborough v. Cromwell,* 326 U. S. 620 (1945).

In determining whether a taxing statute satisfies such requirements the courts look to the incidence of the tax and its practical operation. *International Harvester Co. v. Wisconsin,* 322 U. S. 435 (1943).

C. The Act Is Invalid Because it Creates Arbitrary and Unreasonable Classifications and Attempts to Tax Income Beyond the Taxing Jurisdiction of the Territory.

The Act of January 22, 1949 attempted to impose

a tax of 10% on the entire Federal income tax withholding of all employees, whether resident or nonresident, whose only income from Alaska sources was wages or salaries. No allocation provision of any kind was included for nonresidents who might have some, but not all, of their wages or salary from Alaska sources. Recognizing this defect in the law with respect to vessel personnel of interstate or foreign carriers engaged in the Alaska trade and with respect to the personnel of carriers operating vehicles or airplanes, the Act of March 26, 1949 amended Section 5-B of the original Act by including an allocation provision for these employees.

The effect of this amendment is to provide one basis for determining the amount of tax required to be withheld from the wages of appellant's vessel personnel and an entirely different basis for withholding from the wages of its other employees, nonresidents of the Territory, who also perform services for appellant both within and without the Territory. Moreover, in the case of carriers operating vehicles or airplanes, the allocation provision is in terms applicable to all personnel including, but not restricted to, the crews of such airplanes or vehicles, thus effecting still another classification for the purposes of the withholding tax.

We think it requires no extended discussion to make clear the fact that there is no basis whatever for classifying appellant's vessel personnel one way and its other nonresident employees a different way and employees of land and air carriers still another way in

determining the amount of withholding tax to be deducted from their wages. The effect of the Act is to create arbitrary and unreasonable classifications based upon no real differences since, from any point of view, all employees of appellant and all employees of all taxpayers who are nonresidents of the Territory may properly be taxed only with respect to an allocated portion of their Federal withholding tax. *F. S. Royster Guano Co. v. Virginia,* supra; *Colgate v. Harvey,* supra; *International Harvester Co. v. Wisconsin,* supra; *Montgomery Ward & Co. v. Tax Commission,* supra.

Moreover, the failure to provide an allocation formula for employees other than vessel personnel and personnel of land and air carriers results in imposing a tax upon wages or salary of other nonresident employees which is derived from sources outside the Territory and which is, therefore, not subject to the taxing jurisdiction of the Territory. This result constitutes a violation of the Fifth and Fourteenth amendments as well as the uniformity requirement of the Organic Act and the limitations contained in the Civil Rights Act. It is axiomatic that where no jurisdiction to tax exists any attempt to tax is invalid. *Hans Rees' Sons v. North Carolina,* 283 U. S. 123 (1930); *Piedmont & N. R. Co. v. Query,* 56 F. 2d 172 (1932); *Hart v. Tax Commissioner,* 240 Mass. 37, 132 N. E. 621 (1921); 90 A.L.R. 486. Cf. *Spector Motor Service, Inc. v. Walsh,* 139 F. 2d 809 (1944).

Section 5-A of the Act also attempts to effect a classification of taxpayers which is arbitrary and discriminatory and, as in the case of the withholding tax, to

tax income which is outside the taxing jurisdiction of the Territory. This subsection imposes a tax of 10% of a taxpayer's total Federal income tax, or, in the alternative a tax of 10% of an allocated portion of a taxpayer's total Federal income tax, whichever is less. Of course, in the case of many taxpayers no allocation will be available because all of their income will be exclusively from sources within the Territory.

The allocation formula provided by this subsection ascribes to the Territory that portion of the total Federal income tax that gross receipts derived from sources within the Territory, payroll and value of tangible property located in the Territory, bears to the total gross receipts from sources within and without the Territory, payroll and value of tangible property within and without the Territory. As so constituted we think the allocation formula is a valid one, having received wide recognition elsewhere. *Spector Motor Service, Inc. v. Walsh,* supra. But the subsection does not leave it at that. It goes on to provide that for the purposes of the allocation formula gross receipts from sources within the Territory shall include "income received or derived from sales wherever made of goods, wares and merchandise manufactured or originating in the Territory." For purposes of illustration, the effect of this definition of gross receipts will be to require the inclusion of the entire proceeds from the ultimate sale of the Alaska salmon pack and from Alaska mining operations in gross receipts from Territorial sources in the application of the allocation formula without regard to the extent to which such proceeds are actually derived from Ter-

ritorial sources, as distinguished from activities carried on outside the Territory which contribute to the realization of such proceeds. No such rule is provided for industries other than the manufacturing and extractive industries with the consequence that the latter are classified differently, and very much to their detriment, from other taxpayers. This arbitrary discrimination appears from the face of the statute and, upon the authority of the cases previously cited requires a holding that the statute is invalid. No conceivable basis exists for such a discrimination and the statute suggests none. The Supreme Court has only recently taken occasion to again point out that where no basis for such discriminations are to be found in a statute they cannot be upheld. *Toomer v. Witsell,* supra.

Again, the definition of gross receipts will, in practical operation, impose a tax upon income from sources outside the Territory and beyond the taxing jurisdiction of the Territory.

D. The Act Is Invalid as a Burden on Interstate Commerce.

The commerce clause of the Federal Constitution is a limtiation upon the power of the Territory to enact taxing laws. *Territory of Alaska v. Sears Roebuck & Co.,* 79 F. Supp. 668 (1947).

In recent decisions the Supreme Court has carefully announced the principles which are applicable in cases where the validity of tax legislation is challenged as a violation of that limitation. In *Memphis Natural Gas Co. v. Stone,* 335 U. S. 80 (1948) the Court stated that "a state tax upon a corporation doing only an interstate business may be invalid under our deci-

sions because levied (1) upon the privilege of doing interstate business within the state, or (2) upon some local event so much a part of interstate business as to be in effect a tax upon the interstate business itself." As applied to appellant and to all other taxpayers engaged exclusively, or practically so, in interstate commerce the Alaska Act is invalid under this rule. For example, appellant's business is 94% interstate while that of the companies engaged in salmon packing is entirely interstate. *McComb v. Consolidated Fisheries Co.,* 174 F. 2d 74 (1949). Section 12-C of the Act provides for an automatic suspension of a taxpayer's license to do business in the Territory for failure to pay the income tax. This is, in practical effect, a tax upon the privilege of doing interstate business within the Territory, which may not validly be imposed. The fact that, in the case of appellant, 6% of its business consists of transportation between Alaska ports will not avoid the rule announced by the Supreme Court because (1) it is by comparison too slight to deprive appellant of the protection of the rule, and (2) even if regarded as a local event it is, nevertheless, so much a part of appellant's interstate business that the tax is in effect a tax upon the interstate business itself. Cf. *Atlantic and Pacific Telegraph Co. v. Philadelphia,* 190 U. S. 160 (1903); *Underwood Typewriter Co. v. Chamberlain,* 254 U. S. 1131 (1920).

E. The Attempted Delegation of Authority to the Tax Commissioner Is Invalid.

Section 7-D of the Act dealing with overpayment, credit and refund, authorizes the Tax Commissioner to credit or refund all overpayments of taxes, all taxes

erroneously or illegally assessed or collected, all penalties collected without authority, and all taxes that are found to be unjustly assessed or excessive in amount, or in any manner wrongfully collected. It is also provided that the Tax Commissioner shall by means of rules and regulations specify the manner in which claims for credit or refund shall be made, prescribe limitations and give notice of allowance or disallowance. The subsection then provides that those rules and regulations shall be based upon the provisions of Sections 321 and 322 of the Internal Revenue Code insofar as such provisions are consistent with other provisions of the Alaska statute.

This attempt to delegate to the Tax Commissioner the authority and function of prescribing statutes of limitations and determining the manner in which claims for refunds shall be made, and whether taxes have been unjustly assessed or are excessive in amount or in any manner wrongfully collected is clearly invalid. It is exclusively the function of the legislature to provide statutes of limitations as well as the manner in which refund claims are to be made; and it is exclusively the function of the judiciary to determine the legality of tax assessments and collections.

Moreover, the same objections are applicable to the direction in the statute that the Commissioner shall determine the extent to which Sections 321 and 322 of the Internal Revenue Code are consistent with the Alaska income tax law. Such determinations are not an administrative function. *Terminal R. Ass'n of St. Louis v. U. S.*, 266 U. S. 17 (1924); *Schechter Poultry Corp. v. U. S.*, 295 U. S. 495 (1934); *Kansas*

City Southern Ry. v. U. S., 293 F. 8 (1923); *Acme, Inc. v. Besson,* 10 F. Supp. 1 (1935); *In re Mellea,* 5 F. 2d 687 (1925); *Capital City Gas Co. v. City of Des Moines,* 72 F. 818 (1896).

F. The Act Is Invalid for Indefiniteness and Uncertainty.

In challenging the validity of statutes it is a common practice to assert that they are invalid for indefiniteness and uncertainty. In the majority of such instances the assertion is largely, if not entirely, a formality and relatively few statutes have been condemned for this reason. Nevertheless, there are cases in which statutes have proved to be so indefinite and uncertain that they have been held invalid. The rule is strictly applied to taxing statutes, which must be certain, clear and unambiguous. *State v. Humble Pipe Line Co.,* 112 Tex. 375, 247 S. W. 1082 (1923); 59 C.J. p. 601.

The principal cause of indefiniteness and uncertainty in the Alaska Act is the incorporation by reference of future amendments and revisions of the Internal Revenue Code and of regulations promulgated by the Commissioner of Internal Revenue. Because of this feature of the Act it is impossible for taxpayers to know either at the effective date of the Act or at any subsequent date just what tax liability the statute imposes. A more appropriate case for the application of the rule condemning statutes for indefiniteness and uncertainty can scarcely be imagined. It is no answer to this objection that a taxpayer will ultimately know what his Federal income tax liability is for a given taxable year since what the rule against indefiniteness and uncertainty requires is that

the Alaska statute be definite and certain and not merely that it shall refer to something which has not yet happened but which may happen and which when it does happen may or may not be sufficiently definite and certain in itself.

Another example of indefiniteness and uncertainty in the statute is the use of the word "income" appearing as the first word of the second sentence of section 5-A(2)(a). Nowhere does the Act define "income" and it is, therefore, impossible to ascertain whether it refers to net income or gross income or gross receipts, all of which have in common usage been referred to as income. This makes computation of the tax uncertain.

III

THE SEVERABILITY CLAUSE WILL NOT SAVE THE ACT.

Section 15 of the Act contains the standard severability clause which provides that "if any provision of this Act, or the application thereof to any person or circumstance is held invalid, the remainder of the Act and such application to other persons or circumstances shall not be affected thereby." In the court below appellee urged that even if some provisions of the Act were invalid this clause would save the remainder of the Act.

There are two answers to that contention. First, the Act is invalid in so many respects, as we have shown, that even if the severability clause were applied there would remain a totally inoperative statute which could not possibly be administered as an income tax law. Second, where, as here, the parts of a statute are so inseparably connected with each other the in-

validity of one part makes the entire statute void. *Hill v. Wallace,* 259 U. S. 44 (1922); *Pollock v. Farmers Loan & Trust Co.,* supra.

No method exists by which the court can sever the invalid attempts to delegate legislative functions to Congress, the Commissioner of Internal Revenue and the Tax Commissioner from the remainder of the Act and preserve it. The attempted delegations are part and parcel of the very sections of the Act which impose the income taxes and they so permeate them that severance is impossible without remaking the statute into an entirely different law than the legislature enacted. Such is not a judicial function. *Iselin v. United States,* 270 U. S. 245 (1926); *L. P. Steuart & Bro. v. Bowles,* 322 U. S. 398 (1944). Moreover, even if the references to future amendments of the Internal Revenue Code and regulations of the Commissioner of Internal Revenue were severed from the Act there would follow a complete collapse of the law when any change is made in the Code or the regulations because the Alaska law would then be out of gear with the federal law and the tax could not be ascertained from the income tax returns and determinations made pursuant to that law. And in any event as soon as a change in the federal law or regulations occurs the Alaska statute must fall because there would no longer be any existing Internal Revenue Code or Commissioners regulations which were passed and approved prior to the enactment of the Alaska statute.

This Court may take judicial notice of the fact that the Internal Revenue Code and the Commissioners

regulations have been changed at least once each year for more than ten years.

The same considerations control such invalidities as the attempt to establish arbitrary and unreasonable classifications and to impose burdens on interstate commerce. And, of course, the most striking invalidity of all — the attempt to impose a graduated net income tax — clearly requires a determination that the Act fails in its entirety. *Pollock v. Farmers Loan & Trust Co.,* supra.

IV

WITHHOLDINGS MADE PURSUANT TO THE ACT OF JANUARY 22, 1949, WERE NOT VALIDATED BY THE ACT OF MARCH 26, 1949.

The court held that the Extraordinary Session of the legislature which enacted the original income tax law on January 22, 1949 was an unauthorized session. It was not, in the eyes of the law, a session of the legislature at all and it could not, therefore, take any action which either the regular session or the courts may recognize for any purpose. *Christoffel v. United States*—U. S.—October Term, 1948, No. 528; *Myers v. United States,* 171 F. 2d 800 (1948). As the Supreme Court said in the *Christoffel* case "a tribunal that is not competent is no tribunal." Accordingly, the attempt to preserve by reference action taken at the invalid session is ineffective and the court could not properly find that section 16 of the Act of March 26, 1949 required appellant to pay over income tax withheld pursuant to the Act of January 22, 1949. *Swanson v. Dolezal,* 114 Neb. 540, 208 N. W. 639 (1926); *Norton v. Shelby County,* 118 U. S. 425 (1886). In the *Norton* case the Court said:

" * * * An unconstitutional Act is not a law; it confers no rights; it imposes no duties; it affords no protection; it creates no office; it is, in legal contemplation, as inoperative as though it had never been passed."

V

THE COURT HAVING PROPERLY ASSUMED JURISDICTION OF THE CAUSE SHOULD OBSERVE THE SETTLED RULE OF EQUITY AND DETERMINE ALL QUESTIONS WHICH ARE MATERIAL TO THE CONTROVERSY AND NECESSARY TO AFFORD COMPLETE RELIEF.

With respect to the withholding tax feature of the Alaska Act appellant is not the taxpayer but merely the withholding agency for the collection and payment of the tax which section 5-B imposes upon its employees. *Allen v. Regents of the University System of Georgia,* supra. As previously stated, appellant is enjoined by one court from payment of the tax withheld on seamen's wages and was so enjoined at the time the present case was heard and decided.

As an employer appellant conceives that it has a duty and responsibility to all of its employees to challenge the validity of the withholding tax where required by circumstances to challenge it as to some. Accordingly, since the withholding tax is necessarily invalid if either the withholding tax provision of the statute fails or if the statute is invalid in its entirety for any reason, appellant submits that under established rules of equity the court having once obtained jurisdiction of the controversy should determine all questions material to the determination of appellant's ultimate liability to pay over to the Territory the withheld tax. *Alexander v. Hillman,* supra. This in-

cludes all grounds of invalidity alleged by appellant which appear on or by necessary implication from the face of the statute. To do less would disregard the very purpose of equity jurisdiction — to mold and adjust its action so as to award substantial relief according to the requirements of the case. *Humboldt Savings Bank v. McCleverty,* 161 Cal. 285, 119 P. 82 (1911); *Bowen v. Hockley,* 71 F. 2d 781 (1934). It would also disregard the fundamental rule that equity does not do things by halves. Pomeroy's *Equity Jurisprudence,* 5th Ed., sec. 236a, citing many cases.

The court could not, therefore, properly dismiss appellant's contentions with respect to the validity of the allocation formula of section 5-A, or the failure to achieve equality and uniformity because of the absence of an adjustment for unused net operating losses and unused capital losses, on the ground that such questions were not before the court.

CONCLUSION

For the foregoing reasons, it is respectfully submitted: (1) that the decree of the district court should be reversed to the extent that it holds that chapter 115, Session Laws of Alaska, 1949, is a valid Act; that the term "continental shelf" as used in section 5-B(1) thereof may be severed from the Act without affecting the remainder of the Act; and that section 16 of chapter 115, Session Laws of Alaska, 1949, ratified and confirmed the withholdings of income taxes made pursuant to chapter 3 of the Laws of the Extraordinary Session, Alaska, 1949, and (2) that the case should be remanded to the court for entry of a decree permanently enjoining appellee as prayed for in the original and supplemental complaints filed herein.

Respectfully.

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For Appellant.

August, 1949.

APPENDIX A

Chapter 115, Session Laws of Alaska, 1949

* * *

Section 3. DEFINITIONS.

(8) The words "Internal Revenue Code" mean the Internal Revenue Code of the United States (53 Stat. 1) as amended or as hereafter amended.

* * *

B. REFERENCES TO INTERNAL REVENUE CODE.

(1) Whenever the Internal Revenue Code is mentioned in this Act, the particular portions or provisions thereof, as now in effect or hereafter amended, which are referred to, shall be regarded as incorporated in this Act by such reference and shall have effect as though fully set forth herein.

(2) Whenever any portion of the Internal Revenue Code incorporated by reference as provided in Paragraph (1) of this subsection refers to rules and regulations promulgated by the United States Commissioner of Internal Revenue, or hereafter so promulgated, they shall be regarded as regulations promulgated by the Tax Commissioner under and in accord with the provisions of this Act, unless and until the Tax Commissioner promulgates specific regulations in lieu thereof conformable with this Act.

* * *

Section 5. TAX ON INDIVIDUALS, FIDUCIARIES, CORPORATIONS AND BANKS.

A. GENERAL RULE. There is hereby levied and there shall be collected and paid for each taxable year upon the net income of every individual (except employees whose sole income in Alaska consists of wages or salary upon which tax has been withheld as referred to in subsection B of this Section), fiduciary, cor-

poration and bank, required to make a return and pay a tax under the Federal income tax law, a tax computed by either one of the following methods:

(1) a tax equal to 10 percent of the total income tax that would be payable for the same taxable year to the United States under the provisions of the Internal Revenue Code without the benefit of the deduction of the tax payable hereunder to the Territory.

(2) a tax equal to 10 percent of that portion of the total income tax that would be payable under the provisions of the Internal Revenue Code without the benefit of the deduction of tax payable hereunder to the Territory, that gross receipts derived from sources within the Territory, payroll and value of tangible property located in the Territory, bears to the total gross receipts from sources within and without the Territory, payroll and value of tangible property within and without the Territory.

(a) DETERMINATION OF GROSS RECEIPTS.

Gross receipts from sources within the Territory shall consist of interest, rents, royalties, gains, dividends, all other income and gross income received or derived in connection with property owned or a business or trade carried on and salaries, wages and fees for personal services performed within the Territory. Income received or derived from sales wherever made of goods, wares and merchandise manufactured or originating in the Territory shall be considered to be a part of gross receipts from sources within the Territory.

* * *

B. EMPLOYEES. There is hereby levied upon and there shall be collected from every employee (including persons referred to in subsection (C) of Section 1621 of the Internal Revenue Code) whose sole income in Alaska during the taxable year consists of

wages or salary, a tax in the amount of ten percent of the tax deducted and withheld under the provisions of subchapter (D), Chapter 9, of the Internal Revenue Code, which tax is to be withheld by the employer under the provisions of Section 8 of this Act. The word "employer" includes all Territorial departments, agencies and institutions and political subdivisions; Provided, that the foregoing language of this subsection shall not apply to Federal employees or others not subject to the withholding provisions of this Act, but such persons shall be liable under the general rule set forth in Section 5(A), and must file returns and make payment accordingly, and provided that any person under said withholding provisions whose sole income in Alaska consists of wages or salary, even though he be not required to file a return hereunder, may file such a return, if he so elects, for the purpose of getting his liability fixed in accordance with the rate of tax imposed by the general rule, and making claim for refund of any overpayment.

(1) The tax levied by this subsection shall apply to that portion of the voyage pay of vessel personnel of interstate carriers engaged in the Alaska trade which is earned in the waters of Alaska, including the waters over the continental shelf. The tax shall likewise apply to that portion of the pay earned in Alaska of the personnel of carriers operating vehicles or airplanes on land or in the air on routes to and from Alaska.

* * *

Section 8. COLLECTION OF INCOME TAX AT SOURCE.

* * *

B. REQUIREMENT OF WITHHOLDING. Every employer making payment of wages or salaries shall deduct and withhold a tax in the amount of 10 percent of the tax deducted and withheld under the

provisions of subchapter (D), Chapter 9 of the Internal Revenue Code. Every employer making a deduction and withholding as outlined above, shall furnish to the employee upon request a record of the amount of tax wihtheld from such employee on forms to be prescribed, prepared and furnished by the Tax Commissioner.

* * *

D. PAYMENT OF TAX WITHHELD. Every employer making payments of wages or salaries earned in Alaska, regardless of the place where such payment is made:

(1) shall be liable for the payment of the tax required to be deducted and withheld under this Section and shall not be liable to any individual for the amount of any such payment; and

(2) must make return of and pay to the Tax Commissioner quarterly, or at such other times as the Tax Commissioner may allow, the amount of tax levied which, under the provisions of this Act, he is required to deduct and withhold. Upon failure of the employer to comply with the provisions of this paragraph, the provisions of Section 11 of this Act shall apply.

* * *

Section 12. ENFORCEMENT.

* * *

C. SUSPENSION OF LICENSES. In addition to the other penalties imposed herein, any person authorized to conduct any business by virtue of a license duly issued to him under the laws of Alaska, whether he be a resident or not, shall, if he fails to pay the tax levied under Subsection (A), Section 5 of this Act, suffer suspension of his said license or licenses until the tax imposed by this Act, together with penalties, is paid in full.

* * *

APPENDIX B

Act of Aug. 24, 1912, c. 387, §3, 37 Stat. 512.

§23. CONSTITUTION AND LAWS OF THE UNITED STATES EXTENDED. The Constitution of the United States, and all of the laws thereof which are not locally inapplicable, shall have the same force and effect within the said Territory as elsewhere in the United States. * * *

Act of Aug. 24, 1912, c. 387, §9, 37 Stat. 514

§78. SAME; TAXES TO BE UNIFORM; ASSESSMENTS. All taxes shall be uniform upon the same class of subjects and shall be levied and collected under general laws, and the assessments shall be according to the actual value thereof.

No. 12298

In The United States Court of Appeals
For the Ninth Circuit

ALASKA STEAMSHIP COMPANY, a corporation,
Appellant,

vs.

M. P. MULLANEY, Commissioner of Taxation, Territory of Alaska,
Appellee.

UPON APPEAL FROM THE DISTRICT COURT FOR THE TERRITORY OF ALASKA DIVISION NUMBER ONE

BRIEF OF AMICI CURIAE

JOHN GEISNESS,
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Amici Curiae.

811 New World Life Building,
Seattle 4, Washington.

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UPON APPEAL FROM THE DISTRICT COURT FOR THE TERRITORY OF ALASKA DIVISION NUMBER ONE

BRIEF OF AMICI CURIAE

INTEREST OF *AMICI CURIAE*

Amici curiae filing this brief are attorneys for plaintiffs in three actions pending in the United States District Court for the Western District of Washington, Northern Division, in all of which plaintiff crew members of ships engaged in the Alaska trade seek to enjoin the withholding from seamen's wages of the income tax imposed by the Alaska Net Income Tax Act, Laws of 1949, Chapter 115, Territory of Alaska, effective March 26, 1949. In each of those cases preliminary injunctions have been issued. In the case pending against Alaska Steamship Company the injunction requires the impounding of the tax monies. In the cases involving other companies the preliminary injunctions altogether forbid withholding. All three cases are being

held in abeyance to await the outcome of the instant case, it being recognized that the decision of the court in the instant case will undoubtedly be controlling.

In addition, *amici curiae* represent the general interests of the Sailors' Union of the Pacific and National Organization of Masters, Mates & Pilots in this litigation. The Sailors' Union of the Pacific is an organization that represents all of the unlicensed deck department crew members of all ships regularly engaged in the Alaska trade, including all ships operated by appellant Alaska Steamship Company. National Organization of Masters, Mates & Pilots represents the licensed deck department crew members of all such ships. Both organizations represent a great number of unlicensed and licensed crew members of ships engaged in other trades, so that the interests of those organizations extend beyond the Alaska trade and the Alaska statute.

SUMMARY OF ARGUMENT

The Alaska statute, so far as it attempts to impose a withholding tax upon the earnings of seamen employed by appellant, is invalid because it is in conflict with federal statutes relating to the wages of seamen and because it contravenes the purpose of Congress in enacting those statutes (46 U.S.C.A., Secs 576, 594, 595, 597, 599-605, 642 and 701, appended hereto as Appendix B, pages 30-41).

ARGUMENT

The Alaska Act Is Inconsistent with the Meaning and Purpose of Federal Statutes.

In our view, this case does not depend upon the rules relating to local action respecting a federal subject where federal law is silent. This disposes of *Standard Dredging Company v. Murphy*, 319 U.S. 306, 87 L.ed. 1416.

It may be suggested that if our argument in this brief is correct the result in *Standard Dredging Corp. v. Murphy*, 319 U.S. 306, 87 L.ed. 1416, was wrong. However, there is no inconsistency. There is nothing in the *Standard Dredging* case and companion case to indicate that the employees in question (who worked locally on a barge and floating elevator) were subject to the federal statutes for the protection of seamen hereinafter discussed nor even that the New York law under scrutiny in that case (see footnote 1 of opinion) authorized or required deductions from the pay of employees, which it did not (N.Y. Session Laws, 1935, Sec. 468, and see *Chamberlin v. Andrews*, 2 N.E.(2d) 22, 106 A.L.R. 1519). Furthermore there is no indication that anything similar to the argument we make here was brought forward in the *Standard Dredging* case, where it would have been entirely inappropriate anyway, because no deductions from wages were involved, and certainly no such argument was considered by the court. Finally, since the decision in *Standard Dredging*, the question we raise has become entirely moot as applied to unemployment compensation by reason of a change in the Federal Unemployment Compensa-

tion Act (26 U.S.C.A., Sec. 1606(f)), appended hereto as Appendix E, pages 44-45. By the change we have just mentioned, Congress has specifically authorized deductions from seamen's wages for contribution to state unemployment compensation funds, but allows only one jurisdiction to make the deductions as to each ship.

There is another principle more closely related to our argument but, we believe, separate from it, except for a useful analogy. We refer to the doctrine that Congress by occupying a field may preclude state action that would otherwise be permissible. The rule to which we now refer is not invoked where there is a direct conflict (see *Kelly v. Washington*, 302 U.S. 1, 82 L.ed. 3), but where, in the absence of direct conflict, federal laws are found that are so comprehensive as to manifest an intention to assume completely the control of the subject and by implication all action other than congressional action is prohibited. This rule is developed and expressed in cases such as:

Gibbons v. Ogden, 9 Wheat. 1, 6 L.ed. 23;
Prigg v. Pennsylvania, 16 Pet. 539, 10 L.ed. 1060;

Chesapeake & O. R. Co. v. Stapleton, 279 U.S. 587, 73 L.ed. 861;

Napier v. Atlantic Coast Line R. Co., 272 U.S. 605, 71 L.ed. 432;

Gilvary v. Cuyahoga Valley R. Co., 292 U.S. 57, 78 L.ed. 1123;

Bethlehem Steel Co. v. New York Labor Rel. Bd., 330 U.S. 767, 91 L.ed. 1234.

We do not even have to consider here whether and when the existence of general maritime rules as distinguished from statutes may preclude state action, a possibility recognized by *Standard Dredging Corp. v. Murphy*, 319 U.S. 306, 87 L.ed. 1416, and supported by *Union Fish Co. v. Erickson*, 248 U.S. 308, 63 L.ed. 261, and by *Southern P. Co. v. Jensen*, 244 U.S. 205, 61 L.ed. 1086, read with the suggested interpretation found in *Standard Dredging Corp. v. Murphy, supra.* The federal laws that we set against the Alaska act are all statutes enacted by Congress.

The point we wish to make in this brief is simply that the withholding provisions of the Alaska statute are, as applied to seamen, inconsistent with the meaning of federal statutes dealing with seamen's wages and with the purpose of those statutes. The meaning and the purpose are necessarily interwoven, but so far as practicable we will separately discuss the two aspects. The meaning and effect of the federal statutes are that all deductions from a seaman's wages, except those specifically authorized, are prohibited. Further, the *enforcement* of the withholding provisions of the Alaska act is prohibited as an "arrestment or attachment" under 46 U.S.C.A. 601. And, if the meaning and effect fall short of those results, the Congressional purpose certainly does not, and it is equally effective to nullify the withholding provisions of the Alaska act as applied to seamen. The federal statutes to which we refer are cited in our Summary of Argument and quoted in Appendix B, of this brief, pages 30-41.

Certain decisions squarely support the view that

there is a direct conflict between the Alaska statutory provisions in question and the federal statutes for the protection of seamen we have cited.

In *Shilman v. United States*, 164 F. (2d) 649 (C.C.A. 2, 1947), the court, after reviewing certain of the federal statutes dealing with wages of seamen, said:

> "The above sections look towards payment to the seaman by his employer, at the termination of the employment, of all his earned wages, without any deductions except those expressly authorized by statute."

Some of the statutory provisions mentioned by the court apply to discharges in a foreign port, but the provisions relied upon merely require that in such instance *all wages that are due be paid* in the presence of the U.S. consul and charge the consul with the duty of enforcing the right. And 46 U.S.C.A. Sec. 597, applicable to all domestic discharges, specifies that *every* seaman "when the voyage is ended * * * *shall be entitled to the remainder of the wages which shall be then due him,*" which certainly amounts to the same thing.

In *American-Hawaiian S. S. Co. v. Fisher*, 82 F. Supp. 193 (1948), the Oregon District Court, in holding the Oregon State income tax unconstitutional as applied to seamen said that federal statutes "specify that no deductions shall be made from seamen except as authorized by federal law."

If these interpretations of the federal statutes are correct, the withholding provisions of the Alaska statute obviously can have no application to the seamen employees of appellant.

In addition to the foregoing, the court in *American Hawaiian S. S. Co. v. Fisher, supra,* said:

> "In particular, 46 U.S.C.A. Sec. 601, prohibits the attachment of the wages of seamen and provides that every payment of wages to a seaman shall be valid, notwithstanding any previous sale or assignment thereof or any attachment encumbrance or arrestment thereon. Said provisions of the law of the United States are the supreme law of the land pursuant to Clause 2, Article VI of the Constitution of the United States."

Under both the Oregon statute and the Alaska statute (Sec. 8D (1)), an employer who does not deduct the specified tax from the employee's wage is liable to the creditor State or Territory and, in practical effect, this is indistinguishable from garnishment and garnishment is prohibited under the designation "attachment" in 46 U.S.C.A. 601, as *Wilder v. Inter-Island Steam Navigation Co.*, 211 U.S. 239, 53 L.ed. 164, hereinafter discussed, makes doubly clear. In fact, the Oregon and Alaska statutes, so far as material to this case, are substantially the same, as will readily appear from comparison of the pertinent parts quoted in the appendix of this brief (Appendix C and D, pages 42 and 43).

The only distinction between the withholding provision of the Alaska statute and the ordinary garnishment is that the Alaska statute imposes the withholding burden upon the employer prior to the institution of any court proceeding, whereas, a garnishment does not bind the employer to withhold until the writ has issued and been served, but this distinction

certainly is artificial rather than substantial. In either case, the wage is applied by force of law and legal process to a debt (see Sec. 12A of Alaska act, our Appendix C, page 43, which expressly characterizes the tax obligation a debt).

The Oregon court's view that the withholding provision of the tax statute would amount to an attachment of wages is further supported by the decision of the United States Supreme Court in *Wilder v. Inter-Island Steam Navigation Co.*, 211 U. S. 239, 53 L.ed. 164. The question in that case was whether the prohibition against "arrestment and attachments" precludes garnishment (called an attachment in the Hawaiian statute under consideration) of seamen's wages *after* judgment against the seaman. The court said:

> "Neither of the words used in the statute, 'attachment' or 'arrestment,' considered literally, has reference to executions or proceedings in aid of executions to subject property to the payment of judgments, but refers, as we have seen, to the process of holding property to abide the judgment. But we are of opinion that the statute is not to be too narrowly construed, but rather to be liberally interpreted with a view to effecting the protection intended to be extended to a class of persons whose improvidence and prodigality have led to legislative provisions in their favor, and which has made them, as Mr. Justice Story declared, 'the wards of admiralty.' *Harden v. Gordan*, 2 Mason 541, Fed. Cas. No. 6,047."

Then, after discussing the various statutes enacted to protect the seaman against his own improvidence

and restricting his right to make wage assignments, the court said:

> "Furthermore, there are other sections in the title which strongly support the conclusion that it was not intended that seamen's wages should be seized upon execution or attachment to collect judgments rendered at common law."

After reviewing the sections to which the last quotation relates the court said:

> "We think that these provisions, read in connection with §4536, necessitate the conclusion that it was intended not only to prevent the seaman from disposing of his wages by assignments or otherwise, but to preclude the right to compel a forced assignment, by garnishee or other similar process, which would interfere with the remedy in admiralty for the recovery of his wages by condemnation of the ship."

We believe that the foregoing interpretations of the federal statutes gain support from a consideration of the manner in which the federal statutes came into being. We are now referring to the fact that Congress enacted in *one piece of legislation* the comprehensive Shipping Commissioner's Act of 1872 (17 Stat. at L. p. 262, Act of June 7, 1872, Chap. CCCXXII) (Appendix A, pages 19-30). This Act, the pertinent parts of which we have quoted in the Appendix of this brief, prohibited the receipt of money for providing a seaman with employment (Sec. 11), required all stipulations for allotments, if made at the commencement of a voyage, to be inserted in the employment agreement (Sec. 16), prohibited advances or advance security by seamen, except to the sea-

man himself, or to his wife or mother, and required all deductions to be kept in the log book (Sec. 23), protected him against voluntary abandonment of rights as to wages (Sec. 31); provided that wages do not depend on freight (Sec. 32), and that wages terminate with loss of the ship (Sec. 33), and are not payable if the seaman improperly refuses to work or is lawfully imprisoned (Sec. 34), provided for prompt payment of wages and a penalty for delay (Sec. 35), provided for deductions by way of forfeiture for misconduct (Sec. 51), but strictly regulated the manner of imposition (Sec. 52), provided for the disposition of wages forfeited for desertion (Sec. 55), and for the determination of questions concerning forfeitures or deductions (Sec. 56), provided for a limited reimbursement from seamen's wages for costs incurred by the master for procuring a seaman's conviction (Sec. 57), prohibited attachment of seamen's wages and assignments and sales of wages except advance securities provided for by the Act (Sec. 61), and, generally, provided for the enforcement of the seaman's rights respecting wages and deductions therefrom through the establishment of Shipping Commissioners. This act has, of course, been amended many times, but certainly the amendments evidence no intention to narrow the protection afforded seamen. Further the act was imposed upon random generic laws, so that the complete effect at the time of enactment was to produce an even more comprehensive coverage than our summary shows. What we believe to be all of the current federal statutes dealing to the subject matter are appended hereto as Appendix B, pages 30-41. Of those sections quoted in

Appendix B, all except Section 701 are applicable to the crew members employed by appellant in the coastwise Alaska trade, and all of the sections are applicable to all crew members employed by appellant in any other Alaska trade. We make this statement in the light of Sections 544 and 563 of Title 46 U.S.C.A.

The adoption of this comprehensive plan at one time is certainly more significant evidence of a legislative purpose fully to cover the field of permissible deductions and charges against seamen's wages than a gradual accumulation of fragmentary legislation would be. Congress prohibited "attachments and arrestments," advancements, and allotments, subject to specified exceptions, and made strict provision for penalties and forfeitures resulting in wage deductions. As the Supreme Court said in the *Wilder* case, *supra*, this enactment evidenced an intention to secure to the seaman his wages, and a remedy in an admiralty court for his wages, without permitting any action that might in effect impair or nullify those rights. In order to accomplish this purpose, Congress specifically mentioned and prohibited or restricted all deductions from and charges against seamen's pay. We are quite certain that a withholding provision such as contained in the Alaska statute was not mentioned only because not conceived, or at least not conceived as a practical possibility, by members of Congress in 1872.

We may profitably look at this problem from another aspect. By specific provision in the Alaska law

the tax is a debt (Section 12A, Alaska Act, our Appendix C page 43). If there were no withholding provision in the act, we believe it is clear that Alaska could not collect the tax by garnishment of wages. From this standpoint it seems incredible that Alaska could accomplish the same result by imposing the distraint, if such it may be called, prior to court action.

It seems to us that Section 605 of Title 46, U.S.C. A., strongly supports the inference of a prohibition against deductions not specifically authorized, as drawn from other sections of Title 46. Section 605 provides that when a seaman is paid under the direction of a consular officer or agent at any foreign port or place he shall be paid in gold or its equivalent "without any deduction whatever." We take it that this section confirms our view that Congress intended that every question concerning deductions from a seaman's pay shall be saved until the seaman has the aid of a Shipping Commissioner and access to a convenient admiralty court. Thus, Congress has said that where a seaman is discharged in a foreign port and therefore does not have access to a Shipping Commissioner or United States admiralty court, *no* deduction may be made.

Knowing the purpose of Congress, the Alaska statute should not be sanctioned as applied to seamen merely because an artificial basis has been created to distinguish it from the things expressly prohibited. A statement by Mr. Justice Holmes in *Johnson v. U. S.*, 163 Fed. 30, 32, 18 L.R.A. (n.s.) 1194, C.C.A. 1, is most apt:

"A statute may indicate or require as its jus-

> tification a change in the policy of the law, although it expresses that change only in the specific cases most likely to occur to the mind. The legislature has the power to decide what the policy of the law shall be, and if it has intimated its will, however indirectly, that will should be recognized and obeyed. The major premise of the conclusion expressed in a statute, the change of policy which induces the enactment, may not be set out in terms but it is not an adequate discharge of duty for the courts to say: 'We see what you are driving at, but you have not said it and, therefore, we shall go on as before.' "

This quotation is found in a footnote to *Keifer & Keifer v. R. F. C.*, 306 U.S. 381, 83 L.ed. 784, together with other authorities conveying a similar thought.

The foregoing quotation has peculiar force when applied to the instant case because here the problem is not merely what the acts of Congress mean, but what Congress purposed. Even if the meaning and effect of the federal statutes in question fall short of what we have claimed, surely we have not overstated the congressional intent. We would judge from what Mr. Justice Holmes has said, that, the congressional purpose being known, the statutes should be given meaning and effect, or rules of decision adopted, that effectuate such purpose. However, that particular question cannot possibly arise here because, even if the congressional intent has not been carried into general effect, the *purpose* of Congress precludes any inconsistent local legislation.

The cases involving the principle that the occupation of a field by Congress will preclude state action even as to details not touched upon by the federal law substantiate what we have just said as to the effectiveness of congressional *purpose* as a bar to local action. The theory of the cases involving the doctrine of congressional occupation of a given field is that where Congress has dealt comprehensively with a certain Federal subject and thereby indicated its intention to assume complete control of the subject matter "its silence as to what it does not do is as expressive of what its intention is as the direct provisions made by it." (Quoted in *Chesapeake & O. R. Co. v. Stapleton*, 279 U.S. 587, 73 L.ed. 861, from *Prigg v. Penn.*, 16 Pet. 539, 617, 10 L.ed. 1060, 1089.)

In *Gilvary v. Cuyahoga Valley R. Co.* 292 U.S. 57, 78 L.ed. 1123, the court said that "the purpose exclusively to regulate need not be specifically declared" and, as respects Federal Safety Appliance Acts,

> "So far as the safety equipment of such vehicles is concerned, these Acts operate to exclude state regulation whether consistent, complementary, additional or otherwise."

citing *Prigg v. Penn.*, *supra*, and other cases.

In *Savage v. Jones*, 225 U.S. 501, 533, 56 L.ed. 1182, 1195, the court said:

> "For when the question is whether a federal act overrides a state law, the entire scheme of the statute must, of course, be considered, and that which needs must be implied is of no less force than that which is expressed. If the purpose of the act cannot otherwise be accomplished

> —if its operation within its chosen field else must be frustrated and its provisions refused their natural effect—the state law must yield to the regulation of Congress within the sphere of its delegated power."

In *Cloverleaf Butter Co. v. Patterson*, 315 U.S. 148, 155, 86 L.ed. 754, 762, the court said:

> "Where this power to legislate exists, it often happens that there is only a partial exercise of that power by the federal government. In such cases the state may legislate freely upon those phases of the commerce which are left unregulated by the nation. But where the United States exercises its power of legislation so as to conflict with the regulation of the state, either specifically or by implication, the state legislation becomes inoperative and the federal legislation exclusive in its application.
>
> "When the prohibition of state action is not specific but inferable from the scope and purpose of the federal legislation, it must be clear that the federal provisions are inconsistent with those of the state to justify the thwarting of state regulation."

There is a helpful analogy in many of the cases dealing with the inhibition upon local action respecting certain federal subjects even where there is complete silence in the federal law. Certain of those cases, and perhaps most of them, base the inhibition upon the presumed, though unexpressed, intent of Congress. Such cases are collected in *Southern Pacific Co. v. Arizona*, 325 U.S. 761, 768, 89 L.ed. 1915, 1924. Here again, Congress' unexpressed, but inferred, intent forestalls state action.

Thus, so much of *Southern Pacific Co. v. Jensen*, 244 U.S. 205, 61 L.ed. 1086, as declares that the states lack power

> "to contravene the essential purposes of, or to work material injury to, characteristic features of (the maritime) law"

is still sound, however much the views expressed in the opinion may now be limited in other respects.

In the cases relating to occupation of the field by Congress, and, for that matter in the cases holding complete silence of Congress as to certain subjects implies a prohibition, there is a general negative inference. We mean that there is an implied prohibition against any regulation of the subject matter by local authority. In the instant case the implication is affirmative and, besides, it is not drawn *a priori* from the statutes but is forced into view by the United States Supreme Court in *Wilder v. Inter-Island Steam Navigation Co.*, 211 U.S. 239, 53 L.ed. 164. Congress, according to the Supreme Court, affirmatively disapproves of charges imposed here and there against a seaman's wages and, instead, has closely restricted wage deductions and carefully shielded the seaman's wages until he comes to the port of discharge where he is to be assisted by a federal official, the Shipping Commissioner, and is to have ready access and summary relief in the admiralty courts.

The *Wilder* case asserts the intention of Congress jealously to protect the wages of seamen against deductions and charges until they reach the seaman's pocket and we should bear in mind that the guarantee

stated in the *Wilder* case of a right of access to an admiralty court for an adjudication of all matters pertaining to wages was even more than a guarantee of access to a court of that kind for such purposes. It was the obvious intention to give seamen the aid of Shipping Commissioners and access to a convenient and sympathetic forum at a convenient time to litigate questions pertaining to wages.

A seaman cannot go back to jurisdiction after jurisdiction he has touched to contest charges against his pay. In this respect a statute such as the Alaska act falls afoul of the plain intent and meaning of the federal laws. If the Alaska act be sustained, a seaman on an American ship may theoretically have income tax deductions in twenty or more states and territories (and, practically, in perhaps ten) and be hopelessly handicapped in any adjustments of the tax. Both as a technical and a practical matter it is not sufficient to say that the shipowner should not deduct the tax unless it is properly due. As well say that a suitor and court should not attach wages unless the claim is just and accurately stated. So far as there is any difference it is a difference in degree. In fact, as we read the Alaska act (Sec. 8, C, borrowing 26 U.S.C.A. 1622, which incorporates 26 U.S. C.A. 322(a)), payment to the taxing authority would work an aquittance as far as the ship-owner is concerned so that the seaman would have to take up his troubles with the Territory of Alaska or, if we assume the enactment of such a tax in other jurisdictions, with the various taxing authorities involved. Furthermore, self interest would influence the employer to

favor the Territory rather than the seaman, because the employer is subject to penalties if he does not withhold enough but there is no penalty for withholding too much.

We would assume that if and when Congress is prepared to sanction withholding from seamen's pay of local income taxes it will enact some appropriate legislation that probably will follow along the lines of the policy laid down respecting local unemployment compensation deductions. By 26 U.S.C.A. Sec. 1606 (f) (App. E, pages 44-45, this brief) only one state, the state from which a ship's operations are directed, may impose unemployment compensation charges, but it may impose such charges as to all services by members of the crew of such ship no matter where performed.

CONCLUSION

Section 8 of the Alaska act is inconsistent with the meaning and purpose of the acts of Congress designed to protect the wages of seamen. It is, therefore, plainly invalid and its enforcement should be enjoined.

Respectfully submitted,
JOHN GEISNESS,
BASSETT & GEISNESS
Amici Curiae

APPENDIX A

Shipping Commissioners' Act of 1872

Act of June 7, 1872 (17 St. at L. p. 262), Chap. CCCXXII.—An Act to authorize the Appointment of Shipping-commissioners by the several Circuit Courts of the United States, to superintend the Shipping and Discharge of Seamen engaged in Merchant Ships belonging to the United States, and for the further Protection of Seamen.

SEC. 11. That if any person shall demand or receive, either directly or indirectly, from any seaman seeking employment as a seaman, or from any other person seeking employment as a seaman, or from any person on his behalf, any remuneration whatever, other than the fees hereby authorized, for providing him with employment, he shall, for every such offence, incur a penalty not exceeding one hundred dollars.

SEC. 16. That all stipulations for the allotment of any part of the wages of a seaman during his absence which are made at the commencement of the voyage shall be inserted in the agreement, and shall state the amounts and times of the payments to be made, and the persons to whom such payments are to be made.

SEC. 17. That no advance of wages shall be made or advance security given to any person but to the seaman himself, or to his wife or mother; and no advance of wages shall be made, or advance security given, unless the agreement contains a stipulation for the same, and an accurate statement of the amount

thereof; and no advance wages or advance security shall be given to any seaman except in the presence of the shipping-commissioner.

SEC. 18. That if any advance of wages is made or advance security given to any seaman in any such manner as to constitute a breach of any of the above provisions, the wages of such seaman shall be recoverable by him as if no such advance had been made or promised; and in the case of any advance security so given no person shall be sued thereon unless he was a party to such breach.

SEC. 19. That whenever any advance security is discounted for any seaman, such seaman shall sign or set his mark to a receipt indorsed on the security, stating the sum actually paid or accounted for to him by the person discounting the same; and if the seaman sails in the ship from the port of departure mentioned in the security, and is then duly earning his wages, or is previously discharged with the consent of the master, but not otherwise, the person discounting the security may, ten days after the final departure of the ship from the said port of departure mentioned in the security, sue for and recover the amount promised by the security, with costs, either from the owner or from any agent who has drawn or authorized the drawing of the security, in any justice's or other competent court; and in any such proceeding it shall be sufficient for such person to prove the security was given by the owner or master, or some other authorized agent, and that the same was discounted to and receipted by the seaman, and the seaman shall be presumed to have sailed in

the ship from such port as aforesaid, and to be duly earning his wages, unless the contrary is proved.

SEC. 22. That all seamen discharged in the United States from merchant ships engaged in voyages as described in section twelve of this act shall be discharged and receive their wages in the presence of a duly authorized shipping-commissioner under this act, except in cases where some competent court otherwise directs; and any master or owner of any such ship who discharges any such seaman belonging thereto, or, except as aforesaid, pays his wages within the United States in any other manner, shall incur a penalty not exceeding fifty dollars.

SEC. 23. That every master shall, not less than forty-eight hours before paying off or discharging any seaman, deliver to him, or if he is to be discharged before a shipping-commissioner, to such shipping-commissioner, a full and true account of his wages, and all deductions to be made therefrom on any account whatsoever; and in default shall, for each offence, incur a penalty not exceeding fifty dollars; and no deduction from the wages of any seaman (except in respect of any matter happening after such delivery) shall be allowed, unless it is included in the account delivered; and the master shall, during the voyage, enter the various matters in respect to which such deductions are made, with the amounts of the respective deductions as they occur, in a book to be kept for that purpose, to be called the "Official Log-book," as hereinafter provided, and shall, if required, produce such book at the time of the payment of wages, and, also, upon

the hearing, before any competent authority, of any complaint or question relating to such payment.

SEC. 25. That every shipping-commissioner shall hear and decide any question whatsoever between a master, consignee, agent, or owner, and any of his crew, which both parties agree in writing to submit to him; and every award so made by him shall be binding on both parties, and shall, in any legal proceedings which may be taken in the matter, before any court of justice, be deemed to be conclusive as to the rights of parties, and any document purporting to be under the hand and official seal of a commissioner, such submission or award shall be prima-facie evidence thereof.

SEC. 26. That in any proceeding relating to the wages, claims, or discharge of any seaman, carried on before any shipping-commissioner, under the provisions of this act, such shipping-commissioner may call upon the owner, or his agent, or upon the master, or any mate, or any other member of the crew, to produce any log-books, papers, or other documents in their respective possession or power, relating to any matter in question in such proceedings, and may call before him and examine any of such persons, being then at or near the place, on any such matter; and every owner, agent, master, mate, or other member of the crew, who, when called upon by the shipping-commissioner, does not produce any such books, papers, or documents as aforesaid, if in his possession or power, or does not appear and give evidence, shall, unless he shows some reasonable cause for such a default, for each offence incur a penalty not exceed-

ing one hundred dollars, and, on application being made by the shipping-commissioner, shall be further punished, in the discretion of the court, as in other cases of contempt of the process of the court.

SEC. 27. That the following rules shall be observed with respect to the settlement of wages, that is to say: First, upon the completion, before a shipping-commissioner, of any discharge and settlement, the master or owner and each seaman respectively, in the presence of the shipping-commissioner, shall sign a mutual release of all claims for wages in respect of the past voyage or engagement, and the shipping-commissioner shall also sign and attest it, and shall retain it in a book to be kept for that purpose: *PROVIDED*, That both the master and seaman assent to such settlement, or the settlement has been adjusted by the shipping-commissioner; secondly, such release so signed and attested shall operate as a mutual discharge and settlement of all demands for wages between the parties thereto, on account of wages, in respect of the past voyage or engagement; thirdly, a copy of such release, certified under the hand and seal of such shipping-commissioner to be a true copy, shall be given by him to any party thereto requiring the same, and such copy shall be receivable in evidence upon any future question touching such claims as aforesaid, and shall have all the effect of the original of which it purports to be a copy; fourthly, in cases in which discharge and settlement before a shipping-commissioner are hereby required, no payment, receipt, settlement, or discharge otherwise made, shall operate as evidence of

the release or satisfaction of any claim; fifthly, upon payment being made by a master before a shipping-commissioner, the shipping-commissioner shall, if required, sign and give to such master a statement of the whole amount so paid, and such statement shall, between the master and his employer, be received as evidence that he has made the payments therein mentioned.

SEC. 31. That no seaman shall by any agreement other than is provided by this act forfeit his lien upon the ship, or be deprived of any remedy for the recovery of his wages to which he would otherwise have been entitled; and every stipulation in any agreement inconsistent with any provision of this act, and every stipulation by which any seaman consents to abandon his right to his wages in the case of the loss of the ship, or to abandon any right which he may have or obtain in the nature of salvage, shall be wholly inoperative.

SEC. 32. That no right to wages shall be dependent on the earning of freight by the ship, and every seaman and apprentice who would be entitled to demand and receive any wages if the ship on which he has served and earned freight shall, subject to all other rules of law and conditions applicable to the case, be entitled to claim and recover the same of the master or owner in personam, notwithstanding that freight has not been earned; but in all cases of wreck or loss of ship, proof that he has not exerted himself to the utmost to save the ship, cargo, and stores shall bar his claim.

SEC. 33. That in cases where the service of any seaman terminates before the period contemplated in the agreement, by reason of the wreck or loss of the ship, such seaman shall be entitled to wages for the time of service prior to such termination, but not for any further period.

SEC. 34. That no seaman or apprentice shall be entitled to wages for any period during which he unlawfully refuses or neglects to work when required, after the time fixed by the agreement for his beginning work, nor, unless the court hearing the case otherwise directs, for any period during which he is lawfully imprisoned for any offence committed by him.

SEC. 35. That the master or owner of any ship making voyages as hereinbefore described in section twelve of this act, except foreign-going ships, shall pay to every seaman his wages within two days after the termination of the agreement, or at the time such seaman is discharged, whichever first happens; and in the case of foreign-going ships, within three days after the cargo has been delivered, or within five days after the seaman's discharge, whichever first happens; and in all cases the seaman shall, at the time of his discharge, be entitled to be paid, on account, a sum equal to one-fourth part of the balance due to him; and every master or owner who neglects or refuses to make payment in manner aforesaid without sufficient cause shall pay to the seaman a sum not exceeding the amount of two days' pay for each of the days, not exceeding ten days, during which payment is delayed beyond the respective peri-

ods aforesaid; and such sum shall be recoverable as wages in any claim made before the court; *PROVIDED*, That this section shall not apply to the masters or owners of any vessel where the seaman is entitled to share in the profits of the cruise or voyage.

SEC. 51. That whenever any seaman who has been lawfully engaged, or any apprentice to the sea service, commits any of the following offences, he shall be liable to be punished as follows, that is to say: first, for desertion, he shall be liable to imprisonment for any period not exceeding three months, and also to forfeit all or any part of the clothes or effects he leaves on board, and all or any part of the wages or emoluments which he has then earned; secondly, for neglecting and refusing, without reasonable cause, to join his ship, or to proceed to sea in his ship, or for absence without leave at any time within twenty-four hours of the ship's sailing from any port, either at the commencement or during the progress of any voyage, or for absence at any time without leave, and without sufficient reason, from his ship, or from his duty, not amounting to desertion, or not treated as such by the master, he shall be liable to imprisonment for any period not exceeding one month, and also, at the discretion of the court, to forfeit out of his wages a sum not exceeding the amount of two days' pay, and, in addition, for every twenty-four hours of absence, either a sum not exceeding six day's pay, or any expenses which have been properly incurred in hiring a substitute; thirdly, for quitting the ship without leave after her arrival at her port of delivery, and before she is placed in security, he

shall be liable to forfeit out of his wages a sum not exceeding one month's pay; fourthly, for wilful disobedience to any lawful command, he shall be liable to imprisonment for any period not exceeding two months, and also, at the discretion of the court, to forfeit out of his wages a sum not exceeding four days' pay; fifthly, for continued willful disobedience to lawful commands, or continued willful neglect of duty, he shall be liable to imprisonment for any period not exceeding six months, and also, at the discretion of the court to forfeit, for every twenty-four hours continuance of such disobedience or neglect, either a sum not exceeding twelve days' pay, or any expenses which have been properly incurred in hiring a substitute; sixthly, for assaulting any master or mate, he shall be liable to imprisonment for any period not exceeding two years; seventhly, for combining with any other or others of the crew to disobey lawful commands or to neglect duty, or to impede navigation of the ship, or the progress of the voyage, he shall be liable to imprisonment for any period not exceeding twelve months; eighthly, for willfully damaging the ship or embezzling or wilfully damaging any of the stores or cargo, he shall be liable to forfeit out of his wages a sum equal in amount to the loss thereby sustained, and also, at the discretion of the court, to imprisonment for any period not exceeding twelve months; ninthly, for any act of smuggling of which he is convicted, and whereby loss or damage is occasioned to the master or owner, he shall be liable to pay such master or owner such a sum as is sufficient to reimburse the master

or owner for such loss or damage, and the whole or any part of his wages may be retained in satisfaction or on account of such liability, and shall also be liable to imprisonment for a period not exceeding twelve months.

SEC. 52. That upon the commission of any of the offences enumerated in that last preceding section, an entry thereof shall be made in the official log-book, and shall be signed by the master, and also by the mate or one of the crew; and the offender, if still in the ship, shall, before the next subsequent arrival of the ship at any port, or if she is at the time in port, before her departure therefrom, either be furnished with a copy of such entry, or have the same read over distinctly and audibly to him, and may thereupon make such reply thereto as he thinks fit; and a statement that a copy of the said entry has been so furnished or that the same has been so read over as aforesaid, and the reply (if any) made by the offender, shall likewise be entered and signed in manner aforesaid; and in any subsequent legal proceedings the entries hereinbefore required shall, if practicable, be produced or proved, and in default of such production or proof, the court hearing the case may, at its discretion, refuse to receive evidence of the offence.

SEC. 55. That all clothes, effects, and wages which, under the provisions of this act, are forfeited for desertion, shall be applied, in the first instance, in payment of the expenses occasioned by such desertion to the master or owner of the ship from which the desertion has taken place, and the balance (if any)

shall be paid by the master or owner to any shipping-commissioner resident at the port at which the voyage of such ship terminates; and the shipping-commissioner shall account to and pay over such balance to the judge of the circuit court within one month after said commissioner receives the same, to be disposed of by him in the same manner as is hereinbefore provided for the disposal of the money, effects, and wages of deceased seamen; in all other cases of forfeiture of wages, under the provisions hereinbefore contained, the forfeiture shall be for the benefit of the master or owner by whom the wages are payable; and in case any master or owner neglects or refuses to pay over to the shipping-commissioner such balance aforesaid, he shall incur a penalty of double the amount of such balance, which shall be recoverable by the commissioner in same manner that seamen's wages are recovered.

SEC. 56. That any question concerning the forfeiture of, or deductions from, the wages of any seaman or apprentice may be determined in any proceeding lawfully instituted with respect to such wages, notwithstanding that the offence in respect of which such question arises, though hereby made punishable by imprisonment as well as forfeiture, has not been made the subject of any criminal proceeding.

SEC. 57. That whenever in any proceeding relating to seamen's wages, it is shown that any seaman or apprentice has, in the course of the voyage, been convicted of any offence by any competent tribunal, and rightfully punished therefor by imprisonment or otherwise, the court hearing the case may direct

a part of the wages due to such seaman, not exceeding fifteen dollars, to be applied in reimbursing any costs properly incurred by the master in procuring such conviction and punishment.

SEC. 61. That no wages due or accruing to any seaman or apprentice shall be subject to attachment or arrestment from any court; and every payment of wages to a seaman or apprentice shall be valid in law, notwithstanding any previous sale or assignment of such wages, or of any attachment, incumbrance, or arrestment thereon; and no assignment or sale of such wages, or of salvage made prior to the accruing thereof, shall bind the party making the same, except such advanced securities as are provided for in this act.

APPENDIX B

46 U.S.C.A. §576. Penalty for omitting to begin voyage.

At the foot of every such contract to ship upon such a vessel of the burden of fifty tons or upward there shall be a memorandum in writing of the day and the hour when such seaman who shipped and subscribed shall render himself on board to begin the voyage agreed upon. If any seaman shall neglect to render himself on board the vessel for which he has shipped at the time mentioned in such memorandum without giving twenty-four hours' notice of his inability to do so, and if the master of the vessel shall, on the day in which such neglect happened, make an entry in the log book of such vessel of the name of such seaman, and shall in like manner note the time that he so neglected to render himself after the time

appointed, then every such seaman shall forfeit for every hour which he shall so neglect to render himself one-half of one day's pay, according to the rate of wages agreed upon, to be deducted out of the wages. If any such seaman shall wholly neglect to render himself on board of such vessel, or having rendered himself on board shall afterwards desert, he shall forfeit all of his wages or emoluments which he has then earned. This section shall not apply to fishing or whaling vessels or yachts.

46 U.S.C.A. §593. Termination of wages by loss of vessel; transportation to place of shipment.

In cases where the service of any seaman terminates before the period contemplated in the agreement, by reason of the loss or wreck of the vessel, such seaman shall be entitled to wages for the time of service prior to such termination, but not for any further period. Such seaman shall be considered as a destitute seaman and shall be treated and transported to port of shipment as provided in sections 678, 679, and 681 of this title. This section shall apply to fishing and whaling vessels but not to yachts.

46 U.S.C.A. §594. Right to wages in case of improper discharge.

Any seaman who has signed an agreement and is afterward discharged before the commencement of the voyage or before one month's wages are earned, without fault on his part justifying such discharge, and without his consent, shall be entitled to receive from the master or owner, in addition to any wages he may have earned, a sum equal in amount to one

month's wages as compensation, and may, on adducing evidence satisfactory to the court hearing the case, of having been improperly discharged, recover such compensation as if it were wages duly earned.

46 U.S.C.A. §595. Conduct as affecting right.

No seaman or apprentice shall be entitled to wages for any period during which he unlawfully refuses or neglects to work when required, after the time fixed by the agreement for him to begin work, nor, unless the court hearing the case otherwise directs, for any period during which he is lawfully imprisoned for any offense committed by him.

46 U.S.C.A. §597. Payments at ports.

Every seaman on a vessel of the United States shall be entitled to receive on demand from the master of the vessel to which he belongs one-half part of the balance of his wages earned and remaining unpaid at the time when such demand is made at every port where such vessel, after the voyage has been commenced, shall load or deliver cargo before the voyage is ended, and all stipulations in the contract to the contrary shall be void: *PROVIDED*, Such a demand shall not be made before the expiration of, nor oftener than once in five days nor more than once in the same harbor on the same entry. Any failure on the part of the master to comply with this demand shall release the seaman from his contract and he shall be entitled to full payment of wages earned. And when the voyage is ended every such seaman shall be entitled to the remainder of the wages which shall be then due him, as provided in the preceding section:

PROVIDED FURTHER, That notwithstanding any release signed by any seaman under section 644 of this title any court having jurisdiction may upon good cause shown set aside such release and take such action as justice shall require: *AND PROVIDED FURTHER*, That this section shall apply to seamen on foreign vessels while in harbors of the United States, and the courts of the United States shall be open to such seamen for its enforcement. This section shall not apply to fishing or whaling vessels or yachts.

46 U.S.C.A. §599. Advances and allotments.

(a) It shall be unlawful in any case to pay any seaman wages in advance of the time when he has actually earned the same, or to pay such advance wages, or to make any order, or note, or other evidence of indebtedness therefor to any other person, or to pay any person, for the shipment of seamen when payment is deducted or to be deducted from a seaman's wages. Any person violating any of the foregoing provisions of this section shall be deemed guilty of a misdemeanor, and upon conviction shall be punished by a fine of not less than $25 nor more than $100, and may also be imprisoned for a period of not exceeding six months, at the discretion of the court. The payment of such advance wages or allotment, whether made within or without the United States or territory subject to the jurisdiction thereof, shall in no case except as herein provided absolve the vessel or the master or the owner thereof from the full payment of wages after the same shall have been actually earned, and shall be no defense to a libel suit or

action for the recovery of such wages. If any person shall demand or receive, either directly or indirectly, from any seaman or other person seeking employment, as seaman, or from any person on his behalf, any remuneration whatever for providing him with employment, he shall for every such offense be deemed guilty of a misdemeanor and shall be imprisoned not more than six months or fined not more than $500.

(b) It shall be lawful for any seaman to stipulate in his shipping agreement for an allotment of any portion of the wages he may earn to his grandparents, parents, wife, sister, or children, or for deposits to be made in an account opened by him and maintained in his name either at a savings bank or a United States postal savings depository subject to the governing regulations thereof.

(c) No allotment shall be valid unless in writing and signed by and approved by the shipping commissioner. It shall be the duty of the said commissioner to examine such allotments and the parties to them and enforce compliance with the law. All stipulations for the allotment of any part of the wages of a seaman during his absence which are made at the commencement of the voyage shall be inserted in the agreement and shall state the amounts and times of the payments to be made and the persons to whom the payments are to be made, or by directing the payments to be made to a savings bank or a United States postal savings depository in an account maintained in his name.

(d) No allotment except as provided in this sec-

tion shall be legal. Any person who shall falsely claim to be such relation, as above described, or to be a savings bank or a United States postal savings depository and as such an allottee of the seaman under this section shall for every such offense be punished by a fine not exceeding $500 or imprisonment not exceeding six months, at the discretion of the court.

(e) This section shall apply as well to foreign vessels while in waters of the United States, as to vessels of the United States, and any master, owner, consignee, or agent of any foreign vessel who has violated its provisions shall be liable to the same penalty that the master, owner, or agent of a vessel of the United States would be for similar violation.

The master, owner, consignee, or agent of any vessel of the United States, or of any foreign vessel seeking clearance from a port of the United States, shall present his shipping articles at the office of clearance, and no clearance shall be granted any such vessel unless the provisions of this section have been complied with.

(f) Under the direction of the Secretary of Commerce the Director of the Bureau of Marine Inspection and Navigation shall make regulations to carry out this section. This section shall not apply to fishing or whaling vessels or yachts.

46 U.S.C.A. §600. Agreements as to loss of lien or right to wages.

No seaman shall, by any agreement other than is provided by sections 541-543, 545-549, 561, 562, 564-571, 574-578, 591-597, 600, 602-605, 621-628, 641-643, 644, 645, 651-660, 661-669, 674-679, 682-685,

701-710, and 711-713 of this title, forfeit his lien upon the ship, or be deprived of any remedy for the recovery of his wages to which he would otherwise have been entitled; and every stipulation in any agreement inconsistent with any provision of such sections, and every stipulation by which any seaman consents to abandon his right to his wages in the case of the loss of the ship, or to abandon any right which he may have or obtain in the nature of salvage, shall be wholly inoperative.

46 U.S.C.A. §601. Attachment or arrestment of wages; support of seaman's wife.

No wages due or accruing to any seaman or apprentice shall be subject to attachment or arrestment from any court, and every payment of wages to a seaman or apprentice shall be valid in law, notwithstanding any previous sale or assignment of wages or of any attachment, encumbrance, or arrestment thereon; and no assignment or sale of wages or of salvage made prior to the accruing thereof shall bind the party making the same, except such allotments as are authorized by this title. This section shall apply to fishermen employed on fishing vessels as well as to seamen: *PROVIDED*, That nothing contained in this or sections 80, 569, 596, 597, 599, 656, 673, 701, 703, 712, and 713 of this title shall interfere with the order by any court regarding the payment by any seaman of any part of his wages for the support and maintenance of his wife and minor children.

46 U.S.C.A. §602. Limit of sum recoverable during voyage.

No sum exceeding $1 shall be recoverable from any seaman, by any one person, for any debt contracted during the time such seaman shall actually belong to any vessel, until the voyage for which such seaman engaged shall be ended.

46 U.S.C.A. §603. Summons for non-payment.

Whenever the wages of any seaman are not paid within ten days after the time when the same ought to be paid according to the provisions of sections 541-543, 545-549, 561, 562, 564-571, 574-578, 591-597, 600, 602-605, 621-628, 641-643, 644, 645, 651-660, 661-669, 674-679, 682-685, 701-710, and 711-713 of this title, or any dispute arises between the master and seamen touching wages, the district judge for the judicial district where the vessel is, or in case his residence be more than three miles from the place, or he be absent from the place of his residence, then, any judge or justice of the peace, or any United States commissioner, may summon the master of such vessel to appear before him, to show cause why process should not issue against such vessel, her tackle, apparel, and furniture, according to the course of admiralty courts, to answer for the wages.

46 U.S.C.A. §604. Libel for wages.

If the master against whom such summons is issued neglects to appear, or, appearing, does not show that the wages are paid or otherwise satisfied or forfeited, and if the matter in dispute is not forthwith settled, the judge or justice or United States commis-

sioner shall certify to the clerk of the district court that there is sufficient cause of complaint whereon to found admiralty process; and thereupon the clerk of such court shall issue process against the vessel. In all cases where the matter in demand does not exceed $100 the return day of the monition or citation shall be the first day of a stated or special session of court next succeeding the third day after the service of the monition or citation, and on the return of process in open court, duly served, either party may proceed therein to proofs and hearing without other notice, and final judgment shall be given according to the usual course of admiralty courts in such cases. In such suits all the seamen having cause of complaint of the like kind against the same vessel may be joined as complainants, and it shall be incumbent on the master to produce the contract and log book, if required to ascertain any matter in dispute; otherwise the complainants shall be permitted to state the contents thereof, and the burden of proof of the contrary shall be on the master. But nothing herein contained shall prevent any seaman from maintaining any action at common law for the recovery of his wages, or having immediate process out of any court having admiralty jurisdiction whereever any vessel may be found, in case she shall have left the port of delivery where her voyage ended before payment of the wages, or in case she shall be about to proceed to sea before the end of the ten days next after the day when such wages are due, in accordance with section 596 of this title. This section shall not apply to fishing or whaling vessels or yachts.

46 U.S.C.A. §605. Wages payable in gold.

Moneys paid under the laws of the United States, by direction of consular officers or agents, at any foreign port or place, as wages, extra or otherwise, due American seamen, shall be paid in gold or its equivalent, without any deduction whatever, any contract to the contrary notwithstanding.

46 U.S.C.A. §642. Accounting as to wages.

Every master shall, not less than forty-eight hours before paying off or discharging any seaman, deliver to him, or, if he is to be discharged before a shipping commissioner, to such shipping commissioner, a full and true account of his wages, and all deductions to be made therefrom on any account whatsoever; and in default shall, for each offense, be liable to a penalty of not more than $50. No deduction from the wages of any seaman except in respect of some matter happening after such delivery shall be allowed, unless it is included in the account delivered; and the master shall, during the voyage, enter the various matters in respect to which such deductions are made, with the amounts of the respective deductions as they occur, in the official log book, and shall, if required, produce such book at the time of the payment of wages, and, also, upon the hearing, before any competent authority, of any complaint or question relating to such payment.

46 U.S.C.A. §701. Various offenses; penalties.

Whenever any seaman who has been lawfully engaged or any apprentice to the sea service commits

any of the following offenses, he shall be punished as follows:

First. For desertion, by forfeiture of all or any part of the clothes or effects he leaves on board and of all or any part of the wages or emoluments which he has then earned.

Second. For neglecting or refusing without reasonable cause to join his vessel or to proceed to sea in his vessel, or for absence without leave at any time within twenty-four hours of the vessel's sailing from any port, either at the commencement or during the progress of the voyage, or for absence at any time without leave and without sufficient reason from his vessel and from his duty, not amounting to desertion, by forfeiture from his wages of not more than two days' pay or sufficient to defray any expenses which shall have been properly incurred in hiring a substitute.

Third. For quitting the vessel without leave, after her arrival at the port of her delivery and before she is placed in security, by forfeiture from his wages of not more than one month's pay.

Fourth. For willful disobedience to any lawful command at sea, by being, at the option of the master, placed in irons until such disobedience shall cease, and upon arrival in port by forfeiture from his wages of not more than four days' pay, or, at the discretion of the court, by imprisonment for not more than one month.

Fifth. For continued willful disobedience to lawful

command or continued willful neglect of duty at sea, by being, at the option of the master, placed in irons, on bread and water, with full rations every fifth day, until such disobedience shall cease, and upon arrival in port by forfeiture, for every twenty-four hours' continuance of such disobedience or neglect, of a sum of not more than twelve days' pay, or by imprisonment for not more than three months, at the discretion of the court.

Sixth. For assaulting any master, mate, pilot, engineer, or staff officer, by imprisonment for not more than two years.

Seventh. For willfully damaging the vessel, or embezzling or willfully damaging any of the stores or cargo, by forfeiture out of his wages of a sum equal in amount to the loss thereby sustained, and also, at the discretion of the court, by imprisonment for not more than twelve months.

Eighth. For any act of smuggling for which he is convicted and whereby loss or damage is occasioned to the master or owner, he shall be liable to pay such master or owner such a sum as is sufficient to reimburse the master or owner for such loss or damage, and the whole or any part of his wages may be retained in satisfaction or on account of such liability, and he shall be liable to imprisonment for a period of not more than twelve months.

APPENDIX C

Alaska Net Income Tax Act—L. 1949, c. 115, eff. 3-26-49, §8.

B. Every employer making payment of wages or salaries shall deduct and withhold a tax in the amount of 10 per cent of the tax deducted and withheld under the provisions of subchapter (D), Chapter 9 of the Internal Revenue Code. Every employer making a deduction and withholding as outlined above, shall furnish to the employee upon request a record of the amount of tax withheld from such employee on forms to be prescribed, prepared and furnished by the Tax Commissioner.

D. Every employer making payments of wages or salaries earned in Alaska, regardless of the place where such payment is made:

(1) shall be liable for the payment of the tax required to be deducted and withheld under this section and shall not be liable to any individual for the amount of any such payment; and

(2) must make return of and pay to the tax commissioner quarterly, or at such other times as the tax commissioner may allow, the amount of tax levied which, under the provisions of this act, he is required to deduct and withhold. Upon failure of the employer to comply with the provisions of this paragraph, the provisions of Section 11 of this act shall apply.

E. If the employer is the United States or the territory or a political subdivision thereof, or an agency or instrumentality of any one or more of the foregoing, the return of the amount deducted and with-

held upon any wages or salaries may be made by any officer of said employer having control of the payment of such wages or salaries or appropriately designated for that purpose.

§12.

A. Any tax due and unpaid under this act, and all increases and penalties thereon, shall constitute a debt to the Territory of Alaska and may be collected by lien foreclosure or other court proceedings in the same manner as any other debt in like amount, which remedies shall be in addition to any and all other existing remedies.

APPENDIX D

Oregon Laws 1947, Chap. 536, §110-1620a.

1. Every employer at the time of the payment of wages, salary, bonus or other emolument to any employe shall deduct and retain therefrom an amount equal to 1 per cent of the total amount of such wages, salary, bonus, or other emolument computed without deduction for any amount withheld, and shall, quarterly, on or before the thirtieth day of April, July, October and January pay over to the commission the amount so deducted and retained from wages, salary, bonus or other emolument paid to any employe during the preceding three months. Every amount so paid over shall be accounted for as part of the collections under this chapter. No employe shall have any right of action against his employer in respect of any moneys deducted from his wages and paid over in compliance or intended compliance with this section.

APPENDIX E

26 U.S.C.A. §1606.

(f) The legislature of any State in which a person maintains the operating office, from which the operations of an American vessel operating on navigable waters within or within and without the United States are ordinarily and regularly supervised, managed, directed and controlled, may require such person and the officers and members of the crew of such vessel to make contributions to its unemployment fund under its State unemployment compensation law approved by the Federal Security Administrator (or approved by the Social Security Board prior to July 16, 1946) under section 1603 and otherwise to comply with its unemployment compensation law with respect to the service performed by an officer or member of the crew on or in connection with such vessel to the same extent and with the same effect as though such service was performed entirely within such State. Such person and the officers and members of the crew of such vessel shall not be required to make contributions, with respect to such service, to the unemployment fund of any other State. The permission granted by this subsection is subject to the condition that such service shall be treated, for purposes of wage credits given employees, like other service subject to such State unemployment compensation law performed for such person in such State, and also subject to the same limitation, with respect to contributions required

from such person and from the officers and members of the crew of such vessel, as is imposed by the second sentence (other than clause (2) thereof) of subsection (b) of this section with respect to contributions required from instrumentalities of the United States and from individuals in their employ.

No. 12298

In The United States Court of Appeals
For the Ninth Circuit

ALASKA STEAMSHIP COMPANY, a corporation,
Appellant

vs.

M. P. MULLANEY, Commissioner of Taxation, Territory of Alaska,
Appellee.

UPON APPEAL FROM THE DISTRICT COURT FOR THE TERRITORY OF ALASKA, DIVISION NUMBER ONE

BRIEF OF AMICI CURIAE

SAM L. LEVINSON,
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1602 Northern Life Tower,
Seattle 1, Washington.

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INTEREST OF AMICI CURIAE

Amici curiae filing this brief are attorneys representing the Marine Firemen, Oilers, Watertenders and Wipers, a voluntary association, the Marine Engineers' Beneficial Association, a voluntary association, and the National Union of Marine Cooks and Stewards, a voluntary association. These organizations have intervened in actions pending in the United States District Court for the Western District of Washingon, Northern Division, instituted for the purpose of enjoining the withholding from seamen's wages of the income tax imposed by the Alaska Net Income Tax Law, Laws of 1949, Chapter 115, Territory of Alaska. Preliminary injunctions have been issued by the district court. The final disposition of these cases awaits the outcome of this appeal.

It is to be noted, however, that the interests of these three associations are not confined to the Alaska trade as many of the members are engaged in other trades.

SUMMARY OF ARGUMENT

The imposition by the Territory of Alaska of a withholding provision upon the wages of seamen is invalid, because the necessary consequence of such a provision is the destruction of the uniformity in maritime matters which the Constitution and the acts of Congress are designed to obtain.

ARGUMENT

Admiralty Is a Unique Jurisprudence

Admiralty is a separate and complete jurisprudence, with rules of decision and procedure all its own. It existed in Colonial times and long before and embodies the principles of the general maritime law or the law of the sea. Our Federal Constitution was framed with that in mind and the entire subject—substantive as well as procedural features — was placed under national control because of its intimate relation to navigation and to interstate and foreign commerce. Although the Constitutional provision contains no express grant of legislative power over substantive law, that provision was regarded from the beginning as implicitly investing such power in the United States. Commentators took that view, Congress acted on it, and the courts gave effect to it. Practically, therefore, the situation is as though that view were written into the provision. After the Constitution went into effect, the substantive law theretofore in force was not regarded as superseded or as being only the law of the several states, but as having become the law of the United States—subject to power in Con-

gress to alter, qualify or supplement it as experience or changing conditions might require.[1]

The growth of admiralty and maritime jurisprudence is one of the fascinating aspects of American Constitutional development. It proves that the maritime law of our nation is "flexible enough to keep in step with advancing civilization and do its part in fulfilling the splendid destiny of this republic by the sea."[2]

Parallel of Workmen's Compensation Cases

For this case, the development of the adoption of the principles of the workmen's compensation laws into the Federal system of maritime jurisprudence strikes an interesting and illuminating parallel. On August 15, 1914, Christen Jensen, an employee of the Southern Pacific Company, a Kentucky corporation, was killed while operating a small electric freight truck at Pier 49, North River, New York City. His widow made a claim under the New York Workmen's Compensation Act, which was allowed and approved by the Court of Appeals of New York.[3] The United States Supreme Court held, when the case came before it, that the work in which Jensen was engaged was maritime in its nature, his employment was a maritime contract, the injuries which he sustained were likewise maritime, and the rights and liabilities of the parties were matters clearly within the admiralty jurisdiction. The court stated that, whereas

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[1] *Panama R.R. Co. v. Johnson* (1924) 264 U.S. 375, 386, 68 L. ed. 748, 44 S. Ct. 391.

[2] The *Nanking* (D.C., Cal. 1923) 292 Fed. 642.

[3] 215 N.Y. 514.

exclusive jurisdiction of all civil cases of admiralty and maritime jurisdiction is vested in the Federal district courts, "saving to suitors in all cases, the right of a common law remedy, where the common law is competent to give it," the remedy which the workmen's compensation statute attempted to give was of a character wholly unknown to the common law, incapable of enforcement by the ordinary processes of any court, and was not saved to suitors from the grant of exclusive jurisdiction. The court said:

> "If New York can subject foreign ships coming into her ports to such obligations as those imposed by her Compensation Statute, other States may do likewise. The necessary consequence would be destruction of the very uniformity in respect to maritime matters which the Constitution was designed to establish; and freedom of navigation between the States and with foreign countries would be seriously hampered and impeded.
>
> "No such legislation is valid if it contravenes the essential purpose expressed by an act of Congress or works material prejudice to the characteristic features of the general maritime law or interferes with the proper harmony and uniformity of that law in its international and interstate relations."[4]

This decision caused Congress to pass the Act of October 6, 1917, which added the words "and to claimants the rights and remedies under the work-

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[4]*Southern Pacific Co. v. Jensen* (1916) 244 U.S. 205, 61 L. ed. 1086, 37 S. Ct. 524, L.R.A. 1918-C, 451.

men's compensation law of any state," to clause 3 of Sections 24 and 256 of the Judicial Code.[5]

On August 3, 1918, William M. Stewart, while employed by Knickerbocker Ice Company as a bargeman and doing work of a maritime nature, fell into the Hudson River and drowned. His widow claimed under the Workmen's Compensation Law of New York. She was granted an award and the New York courts approved.[6] But the United States Supreme Court held that the amendment of October 6, 1917, was beyond the power of Congress, whose power to legislate concerning rights and liabilities within the maritime jurisdiction and remedies for their enforcement arises from the Constitution. The court said:

> "The definite object of the grant was to commit direct control to the Federal Government; to relieve maritime commerce from unnecessary burdens and disadvantages incident to discordant legislation; and to establish, so far as practicable, harmonious and uniform rules applicable throughout every part of the Union.
>
> "Congress cannot transfer its legislative power to the States — by nature this is nondelegable."[7]

In the light of the *Stewart* and other cases, Congress again amended clause 3 of Sections 24 and 256 of the Judicial Code to permit application of the

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[5]Act of Oct. 6, 1917, Chap. 97, 40 Stat. at Large 395, 28 U.S.C.A. §§41(3), 371.

[6]226 N.Y. 302.

[7]*Knickerbocker Ice Co. v. Stewart* (1920) 253 U.S. 149, 164, 64 L. ed. 834, 40 S. Ct. 438.

workmen's compensation laws of the several states to injuries within the admiralty and maritime jurisdiction, excepting the masters and crews of vessels, and withheld from the district courts jurisdiction over compensation matters.[8]

This amendment came before the United States Supreme Court in *State of Washington v. W. C. Dawson & Co.*,[9] on the question whether one engaged in stevedoring whose employees worked only on the navigable waters of Puget Sound, could be compelled to contribute to the accident fund provided for by the Washington State workmen's compensation act. The State of Washington contended that the objections pointed out in the *Knickerbocker* case were removed by the Act of June 10, 1922. The court said:

> "Without doubt Congress has power to alter, amend or revise the maritime law by statutes of general application embodying its will and judgment. This power, we think, would permit enactment of a general employers' liability law or general provisions for compensating injured employees; but it may not be delegated to the several states. The grant of admiralty and maritime jurisdiction looks to uniformity; otherwise wide discretion is left to Congress.
>
> "This cause presents a situation where there is no attempt to prescribe general rules. On the contrary, the manifest purpose was to permit any State to alter the maritime law and thereby introduce conflicting requirements. To prevent this result the Constitution adopted the law of

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[8]Act of June 10, 1922, Chap. 216, 42 Stat. at Large 634, 28 U.S.C.A., §§41(3), 371.

[9]264 U.S. 219, 68 L.ed. 646, 44 S.Ct. 302.

> the sea as a measure of maritime rights and obligations. The confusion and difficulty, if vessels were compelled to comply with the local statutes at every port, are not difficult to see. Of course, some within the states may prefer local rules; but the Union was formed with the very definite design of freeing maritime commerce from intolerable restrictions incident to such control. The subject is national. Local interest must yield to the common welfare. The Constitution is supreme."

This decision pointed the way for the Longshoremen's & Harbor Workers' Act [10] But for the purposes of this discussion these decisions illustrate the care with which the Courts protect the admiralty and the maritime jurisdiction of the United States from encroachment by the states, however desirable the ultimate object may be. And these cases and resulting statutes illustrate the fact that the maritime law is capable of growth and expansion without doing violence to its age-old principles, and is able to keep in step with advancing civilization and social progress.[11]

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[10]Act of March 4, 1927, Chap. 509, 33 U.S.C.A. §§ 901-950.
Note that this Act, preserving the principles of maritime law, does not cover the master and the members of the crew or persons employed by the master to load, unload or repair a vessel under 18 tons net.

[11]It is true that these workmen's compensation cases have been criticized. See Mr. Justice Black's reference to them in *Just v. Chambers* (1941), 312 U.S. 383; *Parker v. Motor Boat Sales* (1941), 314 U.S. 244; and *Davis v. Dept. of Labor & Industries* (1942), 317 U.S. 249. But the cases have never been overruled and still stand as landmarks in the history of maritime jurisprudence.

Effect on Maritime Law of Social Security Act

As might be supposed, the advent of social security benefits affected maritime law. An employer of a cook on an hydraulic suction dredge appealed from the imposition upon him of the New York state unemployment compensation tax. The United States Supreme Court, speaking through Mr. Justice Black who admitted that arguably the employees involved, because of the nature of their work, were not within the scope of that portion of admiralty jurisdiction which has been said to be necessarily exclusive, in *Standard Dredging Co. v. Murphy*,[12] reversing the New York court, held the employer liable for contributions.

This case, if ever in point, is no longer of importance, because Congress in August of 1946 amended the Social Security Act[13] and provided that the state in which is maintained the operating office from which maritime vessels are ordinarily and regularly supervised, managed, directed, and controlled, may require the officers and members of the crew of such vessels to contribute to its unemployment fund, and that the officers and members of the crew shall not be required to contribute, with respect to such service, to the unemployment compensation fund of any other state. This statute, preserving the identity and the integrity of the maritime law, has reached out over the "wards of the admiralty"—the officers and

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[12](1943), 319 U.S. 306.

[13]Act of August 10, 1946, Chap. 951, Title III, §301 (a), 60 Stat. at Large 981, which appears as subsection (f) of 26 U.S.C.A. §1606. See Appendix.

members of the crews of American vessels— and has given them the protection afforded other citizens under the unemployment compensation laws. This was done without violence to the age-old law of the sea, and without interference with the conduct of interstate and foreign commerce.

Alaska's Withholding Tax on Seamen's Wages

The specific problem in this case is to determine, in the light of the development of American maritime jurisprudence, whether the Territory of Alaska may impose a withholding provision as a feature of its Territorial Income Tax Act[14] upon officers and members of a crew of vessels engaged in maritime commerce. The problem involves a determination of the effect of this Territorial Act upon the uniformity of maritime matters and the freedom of navigation between the states and with foreign countries which the Constitution was designed to establish. No statute of a state or territory can be valid if it prejudices the symmetry of the general maritime law, as established by the Constitution and by Congress, or interferes with the uniformity of that law in its interstate and international aspects.

When the State of Oregon attempted to collect income taxes due from seamen by requiring their employers to withhold a portion of their wages, Judge McColloch concluded that such a provision was contrary to the Federal statutes which are designed to

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[14]Chap. 115, Laws of 1949, Territory of Alaska.

members of a crew of vessels engaged in maritime

[15]*American-Hawaiian S. S. Co. v. Fisher* (1948), 82 F. Supp. 193.

obtain uniformity.[15] He concluded that 46 U.S.C.A. §§591-605, 682-685 are laws of the United States enacted pursuant to Article III, Section 2, clause 1, and Article I, Section 8, clause 3 of the Constitution of the United States and prescribe the manner in which the wages of seamen shall be paid by employers and specify that no deductions shall be made from the wages of seamen except as authorized by Federal law. These provisions, he said, are laws of the United States enacted under and pursuant to the Constitution to provide a uniform system of law with respect to the wages of seamen, and the Oregon statute is contrary to and in conflict with the Federal law and is invalid as applied to seamen under the Constitution and laws of the United States.

This view is entirely consistent with the concept of maritime jurisprudence as it has grown and developed in America, and is in entire accord with the conclusions of the courts in *Wilder v. Inter-Island Nav. Co.*[16] and *Shilman v. United States.*[17] Mr. Justice Day in the *Wilder* case. discussing the payment of a seaman's wages, said:

> "But we are of the opinion that this statute is not to be too narrowly construed, but rather to be liberally interpreted with a view to affecting the protection intended to a class of persons whose improvidence and prodigality have led to legislative provisions in their favor, and which has made them, as Mr. Justice Story declared, 'the wards of the admiralty'."

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[16]211 U.S. 239, 246, 53 L.ed. 164, 29 S.Ct. 58.

[17](C.C.A. 2, 1947), 164 F.(2d) 649, 650, cert. den. 333 U.S. 837.

Judge Augustus N. Hand expressed the same thought in these words in the *Shilman* case:

> "The above sections [46 U.S.C.A. §§596, 597, 600, 601, 682, 683, and 685] look to the payment to the seaman by his employer, at the termination of the employment, of all his earned wages, without any deductions except those which are expressly authorized by statute."

In 4 Benedict on Admiralty (6th Ed.) §621, is found this statement:

> "The character of seamen and the nature of their employment have induced Congress to provide specially for the collection of their demands. Seamen have always been considered as wards of the admiralty. The wages of their perilous service have been by all nations highly favored in the law. It was the great consideration of policy and justice connected with that humble but most useful class of men that induced the English common law courts to leave to admiralty the undisputed cognizance of suits for seamen's wages and to make those wages a lien upon the last plank of the ship."

Congress may enact statutes of general application, as it has done in regard to seamen's wages, within its power under the Constitution and without distortion of the great design of the maritime law. The courts will give effect to those rules, and, as was said in *Hume v. Moore-McCormack Lines*,[18] in speaking of the "distinctive doctrine" applicable to admiralty:

> "The legislative policy has been to extend that unique protection; in order to effectuate the Congressional intention, statutes of that type have

[18](C.C.A. 2, 1941), 121 F.(2d) 336, 347.

> been liberally construed to favor the seaman (*Bainbridge v. Merchants' & Miners' Transp. Co.*, 287 U.S. 278, 53 S.Ct. 159, 77 L.ed. 302), who has been called the 'ward of the legislature.' That the legislative policy, in turn, should perhaps affect the judicial attitude, even as to matters not completely within the boundaries of a statute, was suggested by Mr. Justice Holmes, on Circuit, in *Johnson v. United States*, 1 Cir., 163 F. 30, 32, 18 L.R.A., N.S., 1194."

If Alaska is allowed to impose its withholding provision on incomes of seamen making voyages there, and the Territory of Hawaii has no such tax law, or a different tax law, the uniformity contemplated by the Constitution is obviously impaired. Or if Alaska is permitted, under some theory, to force the withholding of a part of the wages of seamen, then the Territory of Hawaii and the states can do likewise. Conceivably, in such event, a seaman on a ship leaving Boston and traveling down the Atlantic Coast, through the Gulf, up the Pacific Coast, and on to Alaska, would have taxes withheld from his wages by six or eight states and one territory. If that happened, we suppose that there would be allowed the unfortunate seaman some method of making claim for excess withholding taxes deducted from his wages. But, aside from the problem of the validity of such taxes on nonresidents, the burden placed upon seamen would be excessive, for they still compose that "humble but most useful class of men."

More important, however, than any burden imposed on individual seamen, this type of territorial legislation casts upon maritime commerce the very

kind of burdens and disadvantages which the Constitution sought to avoid by granting direct control to the Federal government. And it obviously interferes with that uniformity which our maritime jurisprudence has consistently strived to maintain. Without discussing other factors, adequately covered in other briefs, which affect the validity of the Alaska Income Tax Act as applied to seamen, it is clearly apparent that this act is not consistent with, and is directly opposed to, the grand scheme of uniformity of our Constitutional system of maritime and admiralty jurisprudence.

CONCLUSION

Section 8 of the Alaska Net Income Tax Law as applied to wages of seamen is contrary to, and in conflict with, the Federal law and is invalid as applied to seamen under the Constitution and laws of the United States. The enforcement of the act should, therefore, be enjoined.

Respectfully submitted,

SAM L. LEVINSON,
EDWIN J. FRIEDMAN,
LEVINSON & FRIEDMAN,
Amici Curiae.

APPENDIX

United States Constitution, Article I, Section 8:

"The Congress shall have power,—

"To regulate commerce with foreign nations and among the several states and with the Indian tribes."

United States Constitution, Article III, Section 2:

"The judicial power shall extend to all cases in law and equity, arising under this constitution, the laws of the United States, and treaties made, or which shall be made, under their authority;—to all cases affecting ambassadors, other public ministers, and consuls;—to all cases of admiralty and maritime jurisdiction;—* * *"

Act of August 10, 1946, 26 U.S.C.A. §1606 (f):

"The legislature of any State in which a person maintains the operating office, from which the operations of an American vessel operating on navigable waters within or within and without the United States are ordinarily and regularly supervised, managed, directed and controlled, may require such person and the officers and members of the crew of such vessel to make contributions to its unemployment fund under its State unemployment compensation law approved by the Federal Security Administrator (or approved by the Social Security Board prior to July 16, 1946) under section 1603 and otherwise to comply with its unemployment compensation law with respect to the service performed by an officer or member of the crew on or in connection with such vessel to the same extent and with the same effect as though such service was performed entirely within such State. Such person and the

officers and members of the crew of such vessel shall not be required to make contributions, with respect to such service, to the unemployment fund of any other State. The permission granted by this subsection is subject to the condition that such service shall be treated, for purposes of wage credits given employees, like other service subject to such State unemployment compensation law performed for such person in such State, and also subject to the same limitation, with respect to contributions required from such person and from the officers and members of the crew of such vessel, as is imposed by the second sentence (other than clause (2) thereof) of subsection (b) of this section with respect to contributions required from instrumentalities of the United States and from individuals in their employ. 53 Stat. 187, amended Aug. 10, 1939, c. 666, Title VI, §613, 53 Stat. 1391; Oct. 23, 1945, c. 433, §7(c), 59 Stat. 549; 1946 Reorg. Plan No. 2, §4, eff. July 16, 1946, 11 F.R. 7873, 60 Stat. 1095; Aug. 10, 1946, c. 951, Title III, §301(a), 60 Stat. 981.

46 U.S.C.A. §596. "Time for payment; double wages recoverable.

"The master or owner of any vessel making coasting voyages shall pay to every seaman his wages within two days after the termination of the agreement under which he was shipped, or at the time such seaman is discharged, whichever first happens; and in case of vessels making foreign voyages, or from a port on the Atlantic to a port on the Pacific, or vice versa, within twenty-four hours after the cargo has been discharged, or within four days after the seaman has been discharged, whichever first happens;

and in all cases the seaman shall be entitled to be paid at the time of his discharge on account of wages a sum equal to one-third part of the balance due him. Every master or owner who refuses or neglects to make payment in the manner hereinbefore mentioned without sufficient cause shall pay to the seaman a sum equal to two days' pay for each and every day during which payment is delayed beyond the respective periods, which sum shall be recoverable as wages in any claim made before the court; but this section shall not apply to masters or owners of any vessel the seamen of which are entitled to share in the profits of the cruise or voyage. This section shall not apply to fishing or whaling vessels or yachts. R.S. §4529; Dec. 21, 1898, c. 28, §§4, 26, 30 Stat. 756, 764; Mar. 4, 1915, c. 153, §3, 38 Stat. 1164."

46 U.S.C.A. §597. "Payment at ports.

"Every seaman on a vessel of the United States shall be entitled to receive on demand from the master of the vessel to which he belongs one-half part of the balance of his wages earned and remaining unpaid at the time when such demand is made at every port where such vessel, after the voyage has been commenced, shall load or deliver cargo before the voyage is ended, and all stipulations in the contract to the contrary shall be void: *Provided*, Such a demand shall not be made before the expiration of, nor oftener than once in five days nor more than once in the same harbor on the same entry. Any failure on the part of the master to comply with this demand shall release the seaman from his contract and he shall be entitled to full payment of wages earned. And when the voyage is ended every such seaman shall be entitled to the remainder of the

wages which shall be then due him, as provided in the preceding section: *Provided further*, That notwithstanding any release signed by any seaman under section 644 of this title any court having jurisdiction may upon good cause shown set aside such release and take such action as justice shall require: *And provided further*, That this section shall apply to seamen on foreign vessels while in harbors of the United States, and the courts of the United States shall be open to such seamen for its enforcement. This section shall not apply to fishing or whaling vessels or yachts. R.S. §4530; Dec. 21, 1898, c. 28, §§5, 26, 30 Stat. 756, 764; Mar. 4, 1915, c. 153, §4, 38 Stat. 1165; June 5, 1920, c. 250, §31, 41 Stat. 1006."

46 U.S.C.A. §600. "Agreement as to loss of lien or right to wages.

"No seaman shall, by any agreement other than is provided by sections 541-543, 545-549, 561, 562, 564-571, 574-578, 591-597, 600, 602-605, 621-628, 641-643, 644, 645, 651-660, 661-669, 674-679, 682-685, 701-710, and 711-713 of this title, forfeit his lien upon the ship, or be deprived of any remedy for the recovery of his wages to which he would otherwise have been entitled; and every stipulation in any agreement inconsistent with any provision of such sections, and every stipulation by which any seaman consents to abandon his right to his wages in the case of the loss of the ship, or to abandon any right which he may have or obtain in the nature of salvage, shall be wholly inoperative. R.S. §4535."

46 U.S.C.A. §601. "Attachment or arrestment of wages; support of seaman's wife.

"No wages due or accruing to any seaman or apprentice shall be subject to attachment or arrestment from any court, and every payment of wages to a seaman or apprentice shall be valid in law, notwithstanding any previous sale or assignment of wages or of any attachment, encumbrance, or arrestment thereon; and no assignment or sale of wages or of salvage made prior to the accruing thereof shall bind the party making the same, except such allotments as are authorized by this title. This section shall apply to fishermen employed on fishing vessels as well as to seamen: *Provided*, That nothing contained in this or sections 80, 569, 596, 597, 599, 656, 673, 701, 703, 712, and 713 of this title shall interfere with the order by any court regarding the payment by any seaman of any part of his wages for the support and maintenance of his wife and minor children. Mar. 4, 1915, c. 153, §12, 38 Stat. 1169."

46 U.S.C.A. §682. "Wages on discharge.

"Upon the application of the master of any vessel to a consular officer to discharge a seaman, or upon the application of any seaman for his own discharge, if it appears to such officer that said seaman has completed his shipping agreement, or is entitled to his discharge under any Act of Congress or according to the general principles or usages of maritime law as recognized in the United States, such officer shall discharge said seaman, and require from the master of said vessel, before such discharge shall be made, payment of the wages which may then be due said seaman; but no payment of extra wages shall be required by any consular officer upon

such discharge of any seaman except as provided in sections 658, 683, 684, and 685 of this title. R.S. §4580; June 26, 1884, c. 121, §2, 23 Stat. 54."

46 U.S.C.A. §683. "Penalty for neglect of consular officer to collect wages; incapacitated seaman.

"If any consular officer, when discharging any seaman, shall neglect to require the payment of and collect the arrears of wages and extra wages required to be paid in the case of the discharge of any seaman, he shall be accountable to the United States for the full amount thereof. The master shall provide any seaman so discharged with employment on a vessel agreed to by the seaman, or shall provide him with one month's extra wages, if it shall be shown to the satisfaction of the consul that such seaman was not discharged for neglect of duty, incompetency, or injury incurred on the vessel. If the seaman is discharged by voluntary consent before the consul he shall be entitled to his wages up to the time of his discharge, but not for any further period. If the seaman is discharged on account of injury or illness, incapacitating him for service, the expenses of his maintenance and return to the United States shall be paid from the fund for the maintenance and transportation of destitute American seamen.

"Provided, That at the discretion of the Secretary of Commerce, and under such regulations as he may prescribe, if any seaman incapacitated from service by injury or illness is on board a vessel so situated that a prompt discharge requiring the personal appearance of the master of the vessel before an American consul or consular agent is impracticable, such seaman may be sent

to a consul or consular agent, who shall care for him and defray the cost of his maintenance and transportation, as provided in this paragraph. R.S. §4581; June 26, 1884, c. 121, §7, 23 Stat. 55; Apr. 4, 1888, c. 61, §3, 25 Stat. 80; Dec. 21, 1898, c. 28, §16, 30 Stat. 759; Mar. 4, 1915, c. 153, §19, 38 Stat. 1185."

46 U.S.C.A. §685. "Wages on justifiable complaint of seaman.

"Whenever on the discharge of a seaman in a foreign country by a consular officer on his complaint that the voyage is continued contrary to agreement, or that the vessel is badly provisioned or unseaworthy, or against the officers for cruel treatment, it shall be the duty of the consul or consular agent to institute a proper inquiry into the matter, and upon his being satisfied of the truth and justice of such complaint, he shall require the master to pay to such seaman one month's wages over and above the wages due at the time of discharge, and to provide him with adequate employment on board some other vessel, or provide him with a passage on board some other vessel bound to the port from which he was originally shipped, or to the most convenient port of entry in the United States, or to a port agreed to by the seaman. R.S. §4588; June 26, 1884, c. 121, §3, 23 Stat. 54; Dec. 21, 1898, c. 28, §18, 30 Stat. 760."

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Appellee.

BRIEF OF AMICUS CURIAE.

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United States Court of Appeals

For the Ninth Circuit

ALASKA STEAMSHIP COMPANY (a corporation),

Appellant,

vs.

M. P. MULLANEY, Commissioner of Taxation, Territory of Alaska,

Appellee.

BRIEF OF AMICUS CURIAE.

PRELIMINARY STATEMENT.

Pursuant to leave of this court, this brief is filed on behalf of Alaska Packers Association as amicus curiae.

This appeal is concerned with the validity under the Constitution and laws of the United States of the Alaska Net Income Tax Act (Session Laws of Alaska 1949, Ch. 115), enacted by the Alaska Legislature on March 26, 1949[1]. The Act imposes a net income tax on corporations, fiduciaries, banks and individuals measured by the taxpayer's federal income tax. Similarly, the Act provides

[1]Pertinent provisions of this act are printed as Appendix A to the Brief for Appellant.

for wage withholdings by employers in amounts based upon the amounts withheld pursuant to the provisions of the Internal Revenue Code. Alaska Packers Association, by virtue of its salmon fishing and canning operations in Alaska, is subject to the taxing jurisdiction of the Territory and to the Alaska Net Income Tax Act. Preliminary computations indicate that over 90 per cent of the Association's annual federal income tax will be allocable to Alaska under the terms of the Act. A substantial part of the Association's net income so taxed by Alaska is also taxed by California and other states. The Association is also subject to the withholding provisions of the Act. Because Alaska Packers Association has a direct and substantial financial interest in the determination of the validity of this act, and because we believe that the court below has committed error in the determination of important constitutional questions, application was made to file a brief as amicus curiae.

A number of issues are presented on this appeal. All of these are discussed in appellant's brief. In this brief we respectfully ask leave to consider two of these issues we deem of exceptional importance: (1) The invalidity of the allocation formula of section 5 A (2) under the due process clause of the Fifth Amendment and the interstate commerce clause of Article I of the Constitution, and (2) the invalidity of the Act as an attempt to delegate legislative functions of the Alaska Legislature to Congress.

I.

THE ALLOCATION FORMULA SET FORTH IN SECTION 5 A (2) OF THE ALASKA NET INCOME TAX ACT VIOLATES THE DUE PROCESS CLAUSE OF THE FIFTH AMENDMENT AND THE INTERSTATE COMMERCE CLAUSE OF ARTICLE I OF THE CONSTITUTION.

A. The decision of the court below.

Section 5 A of the Alaska Net Income Tax Act imposes an income tax on corporations, both foreign and domestic,[2] in the amount of 10 per cent of the taxpayer's federal income tax or, in the alternative, 10 per cent of an allocated portion of the taxpayer's federal income tax. An allocation formula is set forth in section 5 A (2). It apportions to Alaska that portion of a taxpayer's federal income tax which "gross receipts derived from sources within the territory, payroll and value of tangible property located in the territory, bears to the total gross receipts within and without the territory, payroll and value of tangible property within and without the territory." The gross receipts factor in the numerator of this formula is determined in accordance with the provisions of section 5 A (2)(a):

> "(a) *Determination of gross receipts.*—Gross receipts from sources within the territory shall consist of interest, rents, royalties, gains, dividends, all other income, and gross income received or derived in connection with property owned or a business or trade carried on and salaries, wages and fees for

[2]The tax imposed by section 5 A is also applicable to fiduciaries, banks and resident and nonresident individuals, except individuals whose income from Alaska sources consists solely of wages or salary (who are subject to the tax imposed by section 5 B). The lack of jurisdiction in the Alaska Legislature to impose the taxes prescribed in section 5 A exists with respect to nonresident individuals as well as to foreign corporations.

personal services performed within the territory. *Income received or derived from sales wherever made of goods, wares and merchandise manufactured or originating in the territory shall be considered to be a part of gross receipts from sources within the territory.*"[3]

It was contended before the court below (R. 6) that this allocation formula, allocating to Alaska the income derived from sales wherever made of goods, wares and merchandise manufactured or originating in Alaska, is invalid because it results (1) in the taxation of income not subject to the taxing jurisdiction of Alaska in violation of the due process clause of the Fifth Amendment, and (2) in a tax that burdens interstate commerce in violation of the interstate commerce clause of Article I of the Constitution. The court below, in rejecting these contentions, stated (R. 55):

> "However, not only are plaintiff's operations governed by another formula set forth in Section 5 A (2)(b) but specific provision is also made by Section 5 (2)(c) for cases in which either formula produces inequitable results. Moreover, since it is not shown that the plaintiff belongs to the class referred to in the hypothetical cases * * * it cannot be heard on this ground."

In so holding, the court below thus concludes that the constitutional objections are without merit, and at the same time holds that appellant is not permitted to raise these objections.

We submit that the court's holding with respect to the merits of the objections is unsound, for the reasons here-

[3]Italics throughout the brief are added unless otherwise indicated.

inafter stated. As to appellant's status to raise the question, it is true that appellant (unlike Alaska Packers Association, in whose behalf this brief is filed, and numerous other foreign corporations subject to the Act) is not governed by the allocation formula set forth in section 5 A (2)(a).[4] However, that formula, allocating to Alaska income received from sales wherever made of goods manufactured or originating in the Territory is an integral part of the taxing scheme enacted by the Legislature—its essential character being manifest by the fact that Alaska is a land of natural resources largely engaged in export, so that the allocation to it of income from foreign sales of goods originating within the Territory materially affects the revenues, and hence the entire structure of the Act. Numerous cases hold that any person subject to a statute may challenge the validity of any provision thereof, where such provision is an inseparable part of the statute,

> "* * * the principle that the constitutionality of an act may not be raised by one not affected by the invalid part does not apply when the entire act, by which he is affected, is rendered unconstitutional by reason of the part which is void" (*McFarland v. City of Cheyenne* (1935) 48 Wyo. 86, 42 P. 2d 413, 416).

And see:

Carmichael v. Southern Coal Co. (1937), 301 U.S. 495, 513;

Smith v. Thompson (1934), 219 Iowa 501, 258 N.W. 190, 193;

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[4]Appellant, a steamship company, is subject to the allocation formula of section 5 A (2)(b) relating to freight and passenger carriers.

McSween v. State Live Stock Sanitary Board of Florida (1929), 97 Fla. 750, 122 So. 239, 243;
People v. Union Bank & Trust Co. (1935), 362 Ill. 164, 199 N.E. 272, 273.

Moreover, appellant put in issue the validity of the Act as a whole, and has argued, and the court below has passed upon, the constitutional objections to this provision. Accordingly, even if this court should decide that this question is not properly before it, we submit it should make clear that it does not approve or affirm that part of the opinion of the court below which passes on the merits of the question.

B. The allocation formula of section 5 A (2) of the Alaska Net Income Tax Act taxes income beyond the taxing jurisdiction of the Territory of Alaska in violation of the due process clause of the Fifth Amendment.

It has been settled by repeated adjudications of the Supreme Court of the United States that a state is without power to tax income of foreign corporations earned beyond its borders and that any attempt to do so offends the due process clause of the Fourteenth Amendment.

Harvester Co. v. Dept. of Taxation (1944), 322 U.S. 435;
Shaffer v. Carter (1920), 252 U.S. 37;
Hans Rees' Sons v. No. Carolina (1931), 283 U.S. 123;
Underwood T'writer Co. v. Chamberlain (1920), 254 U.S. 113;
Travis v. Yale & Towne Mfg. Co. (1920), 252 U.S. 60;
Bass, Etc., Ltd., v. Tax Comm. (1924), 266 U.S. 271;
Conn. General Co. v. Johnson (1938), 303 U.S. 77.

The taxing power of the Alaska Legislature is similarly restricted. The due process clause of the Fifth Amendment is applicable to territories,

Farrington v. Tokushige (1927), 273 U.S. 284,

and imposes upon territorial legislatures the same restrictions that are imposed on state legislatures by the due process clause of the Fourteenth Amendment.

Farrington v. Tokushige (1927), 273 U.S. 284 (supra);

Heiner v. Donnan (1932), 285 U.S. 312;

Coolidge v. Long (1931), 282 U.S. 582.

It is also settled that while a state or territory may, consistent with the jurisdictional requirements of due process of law, tax a foreign corporation on an allocated portion of its total net income, the allocation formula on its face must be reasonably calculated to reach income derived from sources within the taxing state.

Shaffer v. Carter (1920), 252 U.S. 37 (supra);

Underwood T'writer Co. v. Chamberlain (1920), 254 U.S. 113 (supra);

Travis v. Yale & Towne Mfg. Co. (1920), 252 U.S. 60 (supra);

Bass, Etc., Ltd., v. Tax Comm. (1924), 266 U.S. 271 (supra);

Montgomery Ward & Co. v. State Tax Commission (1940), 151 Kan. 159, 98 P.2d 143.

Even if the allocation formula is fair on its face a taxpayer may avoid its application by showing that in the particular circumstances the formula results in the taxation of income derived from sources beyond the territorial limits of the taxing jurisdiction.

Hans Rees' Sons v. No. Carolina (1931), 283 U.S. 123 (supra).

Section 5 A cannot stand if, as we propose to demonstrate, the prescribed allocation formula on its face results in the taxation of income of foreign corporations earned outside Alaska.

The tax imposed by section 5 A is levied upon the net income of *every* corporation. No distinction is made between domestic and foreign corporations nor between foreign corporations engaged exclusively in interstate commerce and foreign corporations engaged in intraterritorial business in Alaska. The allocation formula prescribed in section 5 A (2) is composed of three factors: gross receipts, payroll, and tangible property. Section 5 A (2)(a) provides that the entire net income of a foreign corporation from the sale *wherever made* of goods manufactured or originating in Alaska must be included in the numerator of the formula as gross receipts derived from sources within Alaska. We submit that this provision necessarily allocates to Alaska income which has its source outside Alaska. The Alaska Legislature apparently assumed that the entire income from the sale of goods produced in Alaska is derived from activities carried on in Alaska. Such an assumption disregards the fundamental economic fact that the total cost of acquiring, producing and marketing goods enters into the production of income from the sales of such goods. It is manifest that if part of these costs are incurred outside Alaska, part of the income from the sales is derived from sources outside Alaska.

The application of the statutory formula to Alaska Packers Association, a California corporation, furnishes an apt illustration and is representative of the effect of the statute on all corporations engaged in fishing, mining

and other businessess which obtain or manufacture goods in Alaska for sale elsewhere. Alaska Packers Association engages in fishing and canning operations in Alaska for approximately three months out of the year. All of the salmon packed in Alaska is transported to and is sold in the United States. A part of the pack is labelled and boxed after its arrival in the United States and a large portion of the pack is stored there for varying lengths of time. Substantial expenditures are incurred in selling, storage, labelling and transportation activities in the United States. Also, the company's administrative and accounting offices in Seattle and San Francisco are largely concerned with the sale of the Alaska salmon pack and the gross receipts from the sale of the pack are obviously attributable in part to expenditures incurred in maintaining these offices. Yet, under the allocation formula of section 5 A (2), Alaska Packers Association is required to allocate to Alaska the entire income derived from the sale of its Alaska salmon pack.

The same situation obtains in the case of all other corporations engaged in the fishing or mining business and any other businesses which obtain or manufacture goods in Alaska for sale elsewhere. Like Alaska Packers Association, many of these corporations are foreign corporations, and taxation of the net income of such corporations derived from sources outside Alaska is prohibited by the Supreme Court decisions referred to above.

The vice of the statutory allocation to Alaska of sales wherever made of goods produced in Alaska is emphasized by the fact that the statute allocates to Alaska gross income from all sales made in Alaska, even though the

goods sold were manufactured or originated outside Alaska. The first sentence of section 5 A (2)(a) of the Act provides that gross receipts from sources within Alaska shall consist of "gross income" received in connection with property owned or business or trade carried on within the Territory. In other words, the statute on its face allocates to Alaska sales made therein of goods produced elsewhere and at the same time also allocates to Alaska sales made outside Alaska of goods produced within Alaska. The Alaska Legislature, unlike the Supreme Court of the United States, has failed to recognize that income of a multistate manufacturing or selling business is derived from activities carried on in each of the states or territories in which the business operates. The Alaska Net Income Tax Act is therefore inconsistent with the principle established by the Supreme Court in the cases cited above, namely, that a state or territory has power to tax a foreign corporation only on that portion of the corporation's net income derived from sources within the taxing state.

At least thirty-three states have enacted corporation income tax laws with allocation formulas applicable to foreign corporations which apportion sales or income from sales to the state in which the sale is made, or in which the goods are located, or in which the goods are consumed, or in which the purchaser of the goods resides.

See,

"Problems of Apportionment in Taxation of Multistate Business," by Leonard L. Silverstein (1949) 4 Tax Law Review 207, 259.

The validity of such income tax laws has been upheld by the Supreme Court of the United States.

West Pub. Co. v. McColgan (1946), 27 Cal.2d 705, 166 P.2d 861, affirmed per curiam (1946) 328 U.S. 823.

A foreign corporation manufacturing or obtaining goods in Alaska and selling the goods in any of these thirty-three states will be required to allocate such sales to both Alaska and the state of sale. It is obvious that if the Alaska Net Income Tax Act is held to be valid, foreign corporations carrying on business activities in Alaska will be subjected to extensive and unwarranted double taxation. Moreover, the allocation to Alaska of sales wherever made of goods produced in Alaska is not necessary in order for Alaska to tax the net income of foreign corporations derived from Alaska sources. A foreign corporation engaged in manufacturing, mining and fishing activities in Alaska necessarily will have a substantial payroll and will own substantial amounts of tangible property in the Territory. The payroll and property factors in the allocation formula would therefore apportion to Alaska income derived from investments in the Territory and from business activities carried on there. Also, sales made in Alaska may constitutionally be allocated to Alaska. But, as is recognized by all of the thirty-three states above referred to, some of the income earned by a foreign corporation engaged in manufacturing or producing goods in one state or territory for sale in another is earned in the states in which the sales are made. Such income is properly apportionable to the state of sale and is reached by such state by allocating sales or income from sales to that state.

cf.

"Allocation of Income in State Taxation," Altman and Keesling, p. 124.

So far as our research discloses, the only case that has considered the validity of an allocation formula comparable to that in the Alaska Act is *New Mexico Glycerin Co. v. Gallegos* (1944) 48 N.M. 65, 145 P.2d 995, where it was held that such an allocation formula, if applied to a foreign corporation, would exceed the taxing power of the state. That case involved a New Mexico income tax statute which provided in part as follows:

> "'(b) If the business of such corporation be transacted both within and without this state the tax imposed shall be upon the portion of such entire net income for each taxable year as is derived from sale, wherever made, or (of) products, goods, wares and merchandise, manufactured or which originated in this state * * *'" (p. 996).

The question in that case was whether a domestic corporation was subject to tax on income derived from business activities carried on in another state. The tax authorities argued that under a section of the statute imposing a tax upon the "net income" of every domestic corporation, the taxpayer was subject to a tax on its entire net income, wherever earned, and that the provision quoted above, providing for an apportionment of income, referred only to foreign corporations. The court held that the quoted provision of the statute applied *only* to *domestic* corporations (pp. 996-997),

> "because the State has no power to impose a tax on the income of a foreign corporation derived from business transacted outside the state, even though the

goods, wares and merchandise from which such income is earned are obtained from within the state."

It should be noted that cases involving franchise taxes imposed upon foreign corporations for the privilege of doing *intrastate* business are not in point.

cf.

Harvester Co. v. Evatt (1947) 329 U.S. 416;
Ford Motor Co. v. Beauchamp (1939) 308 U.S. 330.

As pointed out above, (supra, p. 4), the court below sustained the validity of the allocation formula upon the ground that provision is made by section 5 A (2)(c) for cases in which the formula produces inequitable results. We submit that this ruling is untenable. This section provides, merely, that if the allocation formula enacted by the legislature results in a tax which, in the opinion of the Alaska Tax Commissioner, is "larger" than "in equity and good conscience" the taxpayer should be required to pay, the Commissioner may redetermine the tax in accordance with such "processes and formulas as the tax commissioner shall provide."[5]

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[5]"(c) *Apportionment of tax by tax commissioner.*—If the taxpayer, upon petition to the tax commissioner, as provided in Section 13 of this act, conclusively demonstrates that because of other factors, the method of allocation hereinabove provided, results in a larger tax than in equity and good conscience he should have been required to pay, then the tax shall be determined, allocated and apportioned under such processes and formulas as the tax commissioner shall provide, and the tax commissioner may promulgate proper apportionment rules and regulations conformable with this act for general application in similar cases. In the case of two or more organizations, trades or businesses owned or controlled directly or indirectly by the same interest, the tax commissioner is authorized to distribute, apportion, or allocate the tax where such action is necessary to prevent evasion of payment."

The taxing jurisdiction of the Alaska Legislature is limited to the taxation of income derived from Alaska sources, not by taxation in amounts considered by the Commissioner to be equitable and in accordance with good conscience. Moreover, the standard provided by section 5 A (2)(c) is no standard at all. The tax is left to the whim of the Commissioner, under such processes and formulas as in his absolute discretion he may prescribe. The section offends the most elemenary principles forbidding the delegation of legislative powers.

Panama Refining Co. v. Ryan (1935), 293 U.S. 388; *Schechter Corp. v. United States* (1935), 295 U.S. 495.

C. The tax imposed in accordance with the allocation formula of section 5 A (2) of the Alaska Net Income Tax Act is a burden on interstate commerce in violation of the interstate commerce clause of Article I of the Constitution.

The interstate commerce clause of Article I of the Constitution is a limitation upon the taxing power of a territory.

Territory of Alaska v. Sears Roebuck & Co. (D. Alaska 1947), 79 F. Supp. 668.

As pointed out above, the allocation formula provided by section 5 A (2)(a) of the Alaska Act includes within the income subject to the Alaska tax income from all sales made outside Alaska of goods produced within Alaska. Such a formula involves no apportionment at all. It measures the tax by the taxpayer's entire volume of business outside Alaska which is necessary to the shipment and sale of its merchandise in interstate commerce (see *Gwin, etc., Inc. v. Henneford* (1939) 305 U.S. 434, 437). Clearly

such a tax is invalid as a burden on interstate commerce. As pointed out by the Supreme Court in the *Henneford* case, just cited (p. 439):

> "Here the tax, measured by the entire volume of the interstate commerce in which appellant participates, is not apportioned to its activities within the state. If Washington is free to exact such a tax, other states to which the commerce extends may, with equal right, lay a tax similarly measured for the privilege of conducting within their respective territorial limits the activities there which contribute to the service. The present tax, though nominally local, thus in its practical operation discriminates against interstate commerce, since it imposes upon it, merely because interstate commerce is being done, the risk of a multiple burden to which local commerce is not exposed."

And see:

Adams Mfg. Co. v. Storen (1938), 304 U.S. 307;
Freman v. Hewit (1946), 329 U.S. 249;
Greyhound Lines v. Mealey (1948), 334 U.S. 653;
Memphis Natural Gas Co. v. Stone (1948), 335 U.S. 80.

II.

THE ALASKA NET INCOME TAX ACT IS INVALID BECAUSE IT ATTEMPTS TO DELEGATE TO CONGRESS LEGISLATIVE FUNCTIONS OF THE ALASKA LEGISLATURE.

The Alaska Net Income Tax Act is completely dependent upon the provisions of the Internal Revenue Code. Section 5 A of the Act imposes a tax equal to 10 per cent of the total income tax (or allocated portion

thereof) "that would be payable for the same taxable year to the United States under the provisions of the Internal Revenue Code, without the benefit of the deduction of the tax payable hereunder to the territory." Section 5 B levies a tax "in the amount of ten percent of the tax deducted and withheld under the provisions of subchapter (D), Chapter 9, of the Internal Revenue Code." Section 7 requires every individual (except employees whose sole income in Alaska consists of wages or salary), fiduciary, partnership, corporation and bank "required to make a return under the provisions of the Internal Revenue Code" to make a return under the Act. Also section 7 requires that the amount of tax initially paid under the Act shall be based upon the amount of tax shown on the original federal income tax return of the taxpayer for the taxable year. Finally, section 7 D provides that the rules and regulations established by the Tax Commissioner of Alaska with respect to the credit and refund of overpayments of taxes shall be based upon the provisions of sections 321 and 322 of the Internal Revenue Code in so far as such provisions are consistent with other provisions of the Act.

Section 3 A (8) defines the words "Internal Revenue Code" to mean the "Internal Revenue Code of the United States (53 Stat. 1) as amended *or as hereafter amended.*" Section 3 B provides as follows:

> "(1) Whenever the Internal Revenue Code is mentioned in this act, the particular portions or provisions thereof, as now in effect *or hereafter amended,* which are referred to, shall be regarded as incorporated in this act by such reference and shall have effect as though fully set forth herein.

(2) Whenever any portion of the Internal Revenue Code incorporated by reference as provided in paragraph (1) of this subsection refers to rules and regulations promulgated by the United States Commissioner of Internal Revenue, *or hereafter so promulgated,* they shall be regarded as regulations promulgated by the tax commissioner under and in accord with the provisions of this act, unless and until the tax commissioner promulgates specific regulations in lieu thereof conformable with this act."

In view of the provisions of section 3 A (8) and 3 B, sections 5 and 7 of the Act are clearly invalid as an attempt by the Alaska Legislature to delegate its legislative functions to Congress or the Commissioner of Internal Revenue. The courts have repeatedly held that a state statute which purports to adopt congressional legislation that may be enacted after the effective date of such statute is invalid as an attempt to delegate legislative powers exercisable only by the state legislature.

Hutchins v. Mayo (1940), 143 Fla. 707, 197 So. 495;

State v. Webber (1926), 125 Me. 319, 133 Atl. 738;

Florida Industrial Commission v. State (1945), 155 Fla. 772, 21 So. 2d 599;

State v. Intoxicating Liquors (1922), 121 Me. 438, 117 Atl. 588;

Smithberger v. Banning (1935), 129 Neb. 651, 262 N.W. 492;

Darweger v. Staats (1935), 267 N.Y. 290, 196 N.E. 61;

State v. Gauthier (1922), 121 Me. 552, 118 Atl. 380;

Holgate Brothers Co. v. Bashore (1938), 331 Pa. 255, 200 Atl. 672;

In re Opinion of the Justices (1921), 239 Mass. 606, 133 N.E. 453.

In two cases the courts have been called upon to discuss the very question here in issue, namely, whether a state income tax law imposing a tax measured by a specified percentage of the tax payable under the income tax laws of the United States constitutes an invalid delegation of legislative power.

Santee Mills v. Query (1922), 122 S.C. 158, 115 S.E. 202;

Featherstone v. Norman (1930), 170 Ga. 370, 153 S.E. 58.

In the *Santee Mills* case the state income tax law imposed a tax equal to 33⅓ per cent of the federal income tax imposed by the United States Income Tax Act of November 23, 1921, and acts amendatory thereto " 'which have been passed and approved prior to the time of the approval of this act' " (115 S.E. at p. 205). The court held that the state law did not constitute an invalid delegation of legislative authority because the act did not purport to adopt congressional amendments to the federal income tax law that might be enacted after the effective date of the state act. The opinion makes it clear that the court would have held the statute invalid if it had attempted to embrace any such future amendments, as an improper delegation to Congress of powers reposing only in the state legislature.

Similarly, the court in the *Featherstone* case upheld a state income tax law which adopted certain provisions of the federal income tax laws because "This act in no way

undertakes to make future federal legislation a part of the law of this state upon that subject'' (153 S.E. at p. 70).

The court below recognized that if the principles announced in the foregoing cases were applied, the Alaska Act would be held invalid. But it felt compelled to reject the authority of these cases on the ground, principally, that the Alaska Legislature had no alternative but the one adopted since it meets only once every two years, is not in continuous session, and hence is not in a position to adopt each amendment to the federal laws as it is enacted (R. 53):

> ''Obviously, if the Territorial Legislature were in session continuously, it would be in a position to adopt immediately each amendment to the Federal Laws and Regulations. But since it convenes biennially for a session of sixty days only, there was no alternative but the one to which it resorted.''

Of course, as this court judicially knows, the legislatures of many states meet biennially. This is true in California. Quite apart from the fact that special sessions of the legislature may be called in Alaska, as in the states of the Union, the fact that a legislature meets only once in two years does not render valid an attempt to abdicate its legislative functions.

The court below also relied upon *In re Lasswell* (1934) 1 Cal.App.2d 183, 36 P.2d 678 (R. 53). In that case, the court found that the provision in the California Industrial Recovery Act, that codes adopted by federal authorities under the provisions of the National Industrial Recovery Act should automatically become the California codes, did not constitute an invalid delegation of legislative authority.

The court held that the California legislature had established primary standards for the codes in its own statute and that the delegation to the federal administrative authorities was simply a delegation of the task of filling in details. The case did not involve, and the court did not consider, an attempted delegation of the power to enact changes in substantive law such as that involved in the case at bar.[6]

The court below also held that the objection to the Act as an invalid delegation of legislative power cannot be heard until it is shown that there has been an amendment to the Internal Revenue Code or the Regulations of the Commissioner of Internal Revenue subsequent to the enactment of the Alaska Net Income Tax Act. This holding is directly contrary to the decisions in the cases cited above. The principle which these cases firmly establish is that the legislature of a state or territory is without power to abdicate its responsibilities and authority by providing that Congress shall perform its functions, and that any act so providing, as does the Alaska statute, is invalid *ab initio* because of the attempted delegation. As the Supreme Court of the United States said in *Schechter Corp. v. United States,* 295 U.S. 495, 530:

> "Accordingly, we look to the statute to see whether Congress has overstepped these limitations,—whether Congress in authorizing 'codes of fair competition'

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[6]It should also be noted that the position of the court in the *Lasswell* case, that the California Industrial Recovery Act, which was substantially the same as the National Industrial Recovery Act, established sufficient primary standards, is not consistent with the decisions of the Supreme Court of the United States in *Panama Refining Co. v. Ryan* (1935) 293 U.S. 388, and *Schechter Corp. v. United States* (1935) 295 U.S. 495.

has itself established the standards of legal obligation, thus performing its essential legislative function, or, by the failure to enact such standards, has attempted to transfer that function to others."

The principle involved transcends the importance of any particular statute:

"The question is not of the intrinsic importance of the particular statute before us, but of the constitutional processes of legislation which are an essential part of our system of government" *(Panama Refining Co. v. Ryan,* 293 U.S. 388, 430).

The provisions of the Act incorporating future amendments to the Internal Revenue Code clearly are inseparable. The statute itself demonstrates that the intention of the Alaska Legislature was to impose a continuing tax, measured each year by the federal income tax imposed under the Internal Revenue Code as amended from time to time. Sections 3 A (8) and 3 B (1) and (2), quoted above (supra, p. 16) expressly provide for the incorporation of all future amendments to the Internal Revenue Code; the provisions of section 5 A levy the tax upon persons required to "pay a tax under the federal income tax law" in amounts measured by the total income tax payable *"for the same taxable year* to the United States under the provisions of the Internal Revenue Code" (sec. 5 A (1)); and the administrative provisions of the Act are inseparately connected with similar provisions of the Internal Revenue Code as amended from time to time (sec. 7). There can be no question but that the invalid provisions incorporating future Congressional legislation

"so affect the dominant aim of the whole statute as to carry it down with them" (*Railroad Retirement Board v. Alton R. Co.* (1935) 295 U.S. 330, 362). This is so notwithstanding the separability provision of the Act.

Hill v. Wallace (1922) 259 U.S. 44;

Railroad Retirement Board v. Alton R. Co. (1934) 295 U.S. 330 (supra).

And see cases cited at pages 17 to 18, supra.

As stated by the court in *Smithberger v. Banning* (1935) 129 Neb. 651, 262 N.W. 492 (supra), a case involving an attempted delegation to Congress of a state's legislative power (p. 499):

> "The elimination of the invalid provisions of the legislative acts under consideration and the elimination of the invalid appropriation contained in the statutes leave entirely different statutes from those which were passed by the Legislature, so that it cannot be said it would have passed the acts without said void provisions, and the acts must therefore be held void in their entirety. * * * 'Where valid and invalid parts of a legislative act are so intermingled that they cannot be separated in such a manner as to leave an enforceable statute expressing the legislative will, no part of the enactment can be enforced.'"

CONCLUSION.

For each of the reasons above stated, as well as for other reasons discussed in the appellant's brief, we submit the decision below is erroneous and should be reversed.

Dated, San Francisco, California,
October 10, 1949.

Respectfully submitted,
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NOTE:

The relevant portions of the principal statutes involved are set out in the Appendices.

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BRIEF FOR APPELLEE

OPINION BELOW

The opinion of the District Court is reported in 84 Fed. Supp. 561 (1949).

JURISDICTION

This is a suit to enjoin the appellee from enforcing the provisions of the Alaska Net Income Tax Act against appellant; to have declared invalid the provisions of the Act requiring appellant to withhold for income tax purposes upon the wages of its employees, including seamen; and to have declared invalid the Act in its entirety. Judgment and decree was entered on

July 8, 1949, sustaining the validity of the Act with certain exceptions, vacating a preliminary injunction and dismissing the complaint (R. 68). Petition for allowance of appeal was filed July 9, 1949, and order allowing appeal was signed July 9, 1949, (R. 70, 75). The jurisdiction of the district court was invoked under the Act of June 6, 1900, c. 786, §4, 31 Stat. 322, as amended, 48 USCA §101. The jurisdiction of this court rests on §1291 of the New Federal Judicial Code.

QUESTIONS PRESENTED

1. Whether Chapter 115, Session Laws of Alaska, 1949, known as the Alaska Net Income Tax Act, imposing a net income tax, is a valid exercise of the taxing authority of the Territory.

2. Whether, with regard to certain features of the Alaska Net Income Tax Act, a justiciable controversy is presented.

3. Whether, if some provisions of the Alaska Net Income Tax Act are invalid, the remainder of the Act may be given effect.

STATEMENT

Appellee does not controvert the statement of the case as found in appellant's brief, pages 3 to 7

SUMMARY OF ARGUMENT

I.

The power to enact a graduated net income tax statute is fully within the authority of the territorial legislature as granted to the Territory by Congress in the Organic Act of Alaska.

A. A graduated net income tax adopts a classification that is rationally related to the distribution of the burdens of government, and in its nature it assures

equality of treatment. *Shaffer v. Carter*, 252 U.S. 37 (1919). The Alaska Net Income Tax Act, therefore, satisfying that standard of equality demanded by the equal protection clause of the 14th Amendment, or the Civil Rights Act, (Act of May 31, 1870, c. 114, §16, 116 Stat. 144, 8 USCA §41), also satisfies the uniformity provisions of Section 9 of the Organic Act of Alaska, (Act of Aug. 24, 1912, c. 387, §9, 37 Stat. 514, 48 USCA §78), since the two standards are substantially the same. *Alaska Fish Salting & By-Products Co. v. Smith*, 255 U.S. 44, 49-50 (1920); *Lake Superior Consolidated Iron Mines v. Lord*, 271 U.S. 577, 581 (1925).

B. There is nothing in the Act that can be construed as a hostile or oppressive discrimination against certain classes of taxpayers. The allocation formulae in the Act and the provisions of Section 5A(2) (c) show an intent to adjust the tax burden with a fair degree of equality, all that is necessary in order to satisfy constitutional requirements. *Colgate v. Harvey*, 296 U.S. 404, 422 (1935). Moreover, appellant has not shown itself to be within the class of persons with respect to whom certain portions of the Act are alleged to be unconstitutional, a prerequiste to a decision as to their constitutionality. *Heald v. Dist. of Columbia*, 259 U.S. 114, 123 (1921); *Alabama State Federation of Labor v. McAdory*, 325 U.S. 450, 462-463 (1944).

C. There is no burden on interstate commerce, since the whole purpose of the apportionment formulae and other provisions of the Act is to tax only income derived from property and business within the Territory. *U. S. Glue Co. v. Oak Creek*, 247 U.S. 321

(1917). Section 12. C of the Act does not make the payment of the tax a condition precedent to engage in interstate commerce. *St. Louis S.W. Rwy. Co. v. Kansas*, 235 U.S. 350, 368-371 (1914).

D. The provision for incorporation by reference of future amendments of the Internal Revenue Code and regulations of the Commissioner of Internal Revenue is nothing more than a reference to contingent facts and is to this extent an exercise of legislative will rather than a surrender or delegation of it. However, if this adoption were held to be invalid delegation of legislative power, such provision can be severed from the Act without affecting the validity of the remainder. *Utah Power & Light v. Pfost*, 286 U.S. 165, 184-185 (1932).

E. Section 7. D of the Act, rather than delegating legislative authority to the Tax Commissioner, merely confers upon him a limited discretion as to the manner of effectuating clearly defined legislative policy. The legislature should not be compelled to prescribe detailed rules to cover myriad situations that may possibly arise in the adminstration of a taxing statute. *American Power Co. v. Securities Exch. Comm.*, 329 U.S. 90, 105 (1946).

F. The legislative intent in the Act is clear and unambiguous. There is no warrant for setting the Act aside on asserted grounds of uncertainty and indefiniteness. *Sutherland Statutory Construction, Horack's Third Edition*, Vol. 2, §4920.

II.

Congressional objectives and policy in enacting comprehensive statutes for the protection of seamen are not

defeated by the withholding provisions of the Alaska Net Income Tax Act as they apply to seamen's wages. The essential uniformity of maritime law is not interfered with since here the essential features of an exclusive federal jurisdiction are not involved. *Standard Dredging Co. v. Murphy*, 319 U.S. 306 (1942).

III.

If necessary to be used, the severability provisions of Section 15 of the Act must be given due consideration. *Elec. Bond & Share Co. v. Securities Exch. Comm.*, 303 U.S. 419, 434 (1937). Even assuming that references to future amendments to the Internal Revenue Code and regulations of the Commissioner of Internal Revenue constitute an invalid delegation of legislative authority, there is no warrant for presuming that the legislature intended that the vital objective of the Act, the tax, should not be preserved. *Utah Power & Light Co. v. Pfost*, 286 U.S. 165, 185 (1932).

IV.

The legislature may ratify that which it possesses the power to do in the first instance. Tax withholdings made pursuant to the Act of January 22, 1949, were, therefore, validated by Section 16 of the Act of March 26, 1949. *Board of Education v. Board of Commissioners*, 183 N.C. 776, 111 S.E. 531, 532 (1922).

V.

The rule that equity will determine all questions material to a controversy in order to afford complete relief is no exception to the rule that the court will not give advisory opinions in hypothetical cases. With regard to certain allegations of invalid classifications in the Act, there is no set of facts before the court with

reference to which decision as to constitutionality need be given. *Alabama State Federation of Labor v. McAdory*, 325 U.S. 450, 461-471 (1944).

ARGUMENT

I.

CHAPTER 115, SESSION LAWS OF ALASKA, 1949, IS A VALID EXERCISE OF LEGISLATIVE AUTHORITY GRANTED TO THE TERRITORY OF ALASKA BY CONGRESS IN THE ORGANIC ACT.

A. The Territory has power to enact a graduated income tax law without violating uniformity and equality requirements of the Organic Act and Civil Rights Act.

In Section 9 of the Organic Act of Alaska, (Act of Aug. 24, 1912, c. 387, §9, 37 Stat. 514; 48 USCA 77), Congress has provided that the legislative power of the Territory shall extend to "all rightful subjects of legislation." This includes full and comprehensive power to legislate in matters of taxation, and the territorial income tax law is, therefore, fully within the authority of the legislature. *Peacock v.. Pratt*, 121 F. 772, 775-776 (1903).

Taxation being but the means by which government distributes the burden of its costs among those who enjoy its benefits, *Welch v. Henry*, 305 U.S. 134, 144 (1938), it necessarily follows that once the power to tax exists, classification in a taxing scheme that has a reasonable relation to the equitable distribution of the burden of government and is not arbitrary or capricious, satisfies that standard of equality demanded by the equal protection clause of the 14th Amendment, or the Civil Rights Act. A graduated income tax by its very nature assures equality of treatment

because the burden of the exaction varies with the increase or decrease of earnings and with the comparative success or failure of one's business, *Stewart Dry Goods Co. v. Lewis*, 294 U.S. 550, 560 (1934), and thus has a rational relation to the capacity to pay and the justice of the payment. *Shaffer v. Carter*, 252 U.S. 37, 51 (1919). Cf. *Fox. v. Standard Oil Co. of N. J.*, 294 U.S. 87, 101 (1934).. As was stated in *Shaffer v. Carter*, supra, Pg. 51, by Mr. Justice Pitney:

> "Income taxes are a recognized method of distributing the burdens of government, favored because requiring contributions from those who realize current pecuniary benefits under the protection of the government and because a tax may be readily proportioned to their ability to pay . . . ."

And since the standard of uniformity under Section 9 of the Organic Act is substantially the same as the standard of equality under the 14th Amendment to the Federal Constitution, the requirement of uniformity in Section 9 is disposed of by what has been said of the classification when considered with reference to the Constitution. *Alaska Fish Salting & By-products Co. v. Smith*, 255 U.S. 44, 49-50 (1920); *State Board of Tax Commissioners v. Jackson*, 283 U.S. 527, 542 (1930); *Fox v. Standard Oil Co. of N. J.*, 294 U.S. 87, 102 (1934); *Lake Superior Consolidated Iron Mines v. Lord*, 271 U.S. 577, 581 (1925). Cf. *Ballester-Ripoll v. Court of Tax Appeals of Puerto Rico*, 142 F. (2d) 11, 18 (1944).

A graduated net income tax is not a direct tax on property. The case of *Pollock v. Farmers' Loan & Trust Co.*, 157 U.S. 429 (1894), cited by appellant in

its brief, (pg. 22), did not hold that income taxes necessarily came within the class of direct taxes on property, *Brushaber v. Union Pac. R.R.*, 240 U.S. 1 (1916), but only that taxes on incomes from certain sources would be held to be direct taxes within the meaning of the constitutional requirement as to apportionment. *Bowers v. Kerbaugh-Empire Co.*, 271 U.S. 171, 174 (1925); *N. Y. ex rel Cohn v. Graves*, 300 U.S. 308, 315 (1936). The Act does not levy a tax on income derived only from rents of land, but on income from all sources, and therefore, does not place a special burden upon property by virtue of the ownership thereof. *Miles v. Dept .of Treasury*, 209 Ind. 172, 199 N.E. 372 (1935); *Featherstone v. Norman*, 170 Ga. 370, 153 S.E. 58 (1930).

B. The Act does not create arbitrary or unreasonable classifications in violation of the Civil Rights Act or the Organic Act, and does not attempt to tax income beyond the taxing jurisdiction of the Territory.

(1) It is hardly conceivable that the legislature's failure to take into consideration taxpayers' unused net operating loss deductions under Section 122 of the Internal Revenue Code can be construed as a hostile and oppressive discrimination against those operators who have no net operating loss deductions. (Appellant's Brief, pg. 23, 24.) These are nothing more than possible differences in tax burdens not shown to be substantial, and there is nothing here that indicates an arbitrary or capricious exercise of legislative discretion. *Welch v. Henry*, 305 U.S. 134, 145. Equality of treatment demanded by the Organic Act and the Civil Rights Act does not require the legislature to maintain rigid rules of taxation, achieve scientific

uniformity, or resort to meticulous adjustments in the creation of taxing statutes. *Welch v. Henry*, supra; *Fox v. Standard Oil Co. of N. J.*, 294 U.S. 87, 102 (1934); *Carmichael v. So. Coal Co.*, 301 U.S. 495, 510 (1936); *Mutual Loan Co. v. Martell*, 222 U.S. 225, 235 (1911).

(2) The fact that no allocation formula is set out in the Act for the non-resident employees of appellant who are not vessel personnel does not establish unconstitutionality. (Appellant's Brief, pg. 25, 26.) There is nothing contained in the Act which indicates an intent to impose a greater tax on non-voyage personnel who have been employed in Alaska for the same length of time and at the same rate of pay as voyage personnel—the only intent is to tax the non-resident non-voyage employees of appellant with respect to a portion of their Federal withholding tax which is properly allocable to income obtained within the Territory. This legislative objective is legitimate. *Shaffer v. Carter*, 252 U.S. 37, 52 (1919).

Also there is no showing in the record that any non-voyage employees of appellant who have been employed in the Territory for any length of time and for whom no apportionment formula was provided in the Act have been discriminated against by the imposition of a tax higher than that imposed on other employees in similar circumstances but for whom an apportionment formula is provided. Appellant, in effect, is contending that the Act may possibly be applied unconstitutionally at some indefinite future time, and moreover, applied not to it but to others. The court will not, in advance of such applications,

pass upon different phases of a statute as comprehensive as this until faced with cases involving particular provisions as specifically applied to persons who claim to be injured. It is a settled rule that courts will not give advisory opinions in hypothetical cases. *Watson v. Buck*, 313 U.S. 387, 402 (1940); *Anderson Nat'l. Bank v. Luckett*, 321 U.S. 233, 242 (1943); *Alabama State Federation of Labor v. McAdory*, 325 U.S. 450, 462-463 (1944); *Heald v. District of Columbia*, 259 U.S. 114, 123 (1921); *Jeffrey Mfg. Co. v. Blagg*, 235 U.S. 571, 576 (1914); *Hawkins v. Bleakly*, 243 U.S. 210, 214 (1916).

(3) No invalid discrimination between manufacturing and extractive industries and other industries results from the allocation formula under Section 5 A. (2) (a) of the Act which provides that gross receipts from sources within the Territory shall include "income received or derived from sales wherever made of goods, wares and merchandise manufactured or originating in the Territory." Appellant has not shown itself to be within the class of persons with respect to whom this part of the Act is alleged to be unconstitutional, *Heald v. District of Columbia*, 259 U.S. 114 (1921), and, moreover, even if the "manufacturing or extractive industries" could show that the definition of gross receipts in this subsection would produce inequitable results if included in the allocation formula applicable to them, another provision of the Act, Section 5 A. (2) (c), will take care of such situations. And it is not reasonable to assume in advance that the Commissioner of Taxation will discriminate against the "manufacturing or extractive industries" by refusing to adhere to the legislative

command in this latter section of the Act to allocate the tax in a different manner in the event the allocation formula governing such industries appears to produce inequitable results. As was stated in *Watson v. Buck*, 313 U.S. 387, 402 (1940), by Mr. Justice Black:

> ". . . . . Since all contingencies of attempted enforcement cannot be envisioned in advance of these applications, courts have in the main found it wiser to delay in passing upon the constitutionality of all the separate phases of a comprehensive statute until faced with cases involving particular provisions as specifically applied to persons who claim to be injured. Passing upon the possible significance of the manifold provisions of a broad statute in advance of efforts to apply the separate provisions is analagous to rendering an advisory opinion upon a statute or a declaratory judgment upon a hypothetical case. It is of course conceivable that a statute might be flagrantly and patently violative of express constitutional prohibitions in every clause, sentence and paragraph, and in whatever manner and against whomever an effort might be made to apply it. It is sufficient to say that the statutes before us are not of this type . . . ."

See also *Alabama State Federation of Labor v. McAdory*, 325 U.S. 450, 461-462 (1944).

Therefore, rather than showing a clear indication that the purpose or effect of the Act is a hostile or oppressive discrimination against particular classes of taxpayers, a prerequisite to the avoidance of the law on constitutional grounds of inequality, *Heisler v. Thomas Colliery Co.*, 260 U.S. 245, 255 (1922); *Mad-*

den v. Ky., 309 U.S. 83, 88 (1939), the obvious intent and general operation of the Act is to adjust the tax burden with a fair and reasonable degree of equality. This is all that is necessary to satisfy the standard of equality demanded by the Civil Rights Act. *Colgate v. Harvey*, 296 U.S. 404, 422 (1935).

Some reliance is placed by appellant on the contention that the alleged discrimination has a result of imposing a tax on income derived from sources outside the Territory, thus constituting a violation of the 5th Amendment to the Federal Constitution. Suffice it to say, no attempt has been made to enforce the Act in a manner that would produce such a result, and, therefore, what has been said above with regard to the asserted invalid classification disposes of this contention. *Watson v. Buck*, 313 U.S. 387, 402 (1940).

C. The Act does not impose an unconstitutional burden upon interstate commerce.

Once it is decided that the Territory may consistently with due process of law impose a general net income tax on non-residents from their property and business within the Territory, *Shaffer v. Carter*, 252 U.S. 37 (1919), it is no objection, as far as the commerce clause is concerned, that the tax is imposed on gains derived in part, or even mainly, from interstate commerce. *Underwood Typewriter Co. v. Chamberlain*, 254 U. S. 113, 119-120 (1920). The whole purpose of the apportionment formula in Section 5 A (2) (b) and the provisions of Section 5 A (2) (c) is to impose a tax on appellant which is fairly apportioned to its net gains derived solely from its property and business within the Territory, and when this is done,

there can be no unconstitutional burden upon interstate commerce. *U. S. Glue Co. v. Oak Creek*, 247 U.S. 321 (1917); *Western Livestock v. Bureau of Revenue*, 303 U.S. 250, 255-256 (1937); *Central Greyhound Lines v. Mealey*, 334 U.S. 653, 663 (1947). The tax is non-discriminatory, that is, it places no greater burden on interstate commerce than it does on intrastate commerce of like character, and it is not open to the objection of possible multiple state taxation since no other state can consistently with due process impose an income tax measured by gains derived from property and business within the Territory. The apportionment formula is itself a guard against such a vice. See concurring opinion of Mr. Justice Rutledge in *Memphis Natural Gas Co. v. Stone*, 335 U.S. 80, 96-97 (1947). Plainly, the Territory has attempted to tax only that which it is entitled to tax and there is nothing about the apportionment formula which demonstrates that an unfair and inequitable result would be reached. *International Harvester Co. v. Evatt*, 329 U.S. 416, 421-422 (1946).

Section 12 C of the Act is merely one of the methods adopted by the legislature for enforcement of payment of the tax and it is not required to be construed so as to make such payment a condition precedent to engaging in interstate commerce. Since the tax applies to all persons conducting a business in the Territory, irrespective of whether they are engaged in commerce, it was natural that the language of Section 12 C with such broad scope should be adopted. No situation has yet arisen where the provisions of this section have been applied in such a manner as to deprive appellant

of its privilege of engaging in an interstate business, and it is not to be presumed that the Territory, through its judicial and administrative officers, will not interpret these provisions as being limited in operation to suspension for non-payment of the tax of only the privilege of doing an intrastate business. *St. Louis S.W. Ry. Co. v. Kansas*, 235 U.S. 350, 368-371 (1914). When the legislature enacts a statute, there is no presumption that it intended to exceed the limits of the Constitution. It is a fundamental rule that the courts will adopt that construction of a statute which will uphold its validity. *St. Louis S.W. Ry. Co. v. Kansas*, supra; *Corp. Comm. of Oklahoma v. Lowe*, 281 U.S. 431, 438 (1929); *So. Utah Mines & Smelters v. Beaver County*, 262 U.S. 325, 331 (1922); *Plymouth Coal Co. v. Pa.*, 232 U.S. 531, 546 (1913).

D. The Act does not invalidly delegate legislative functions to Congress.

When the Net Income Tax Act was enacted by the territorial legislature, it became a complete law having its own binding force and not dependent upon additional consent or action for its existence and operation. The question of expediency or discretion in imposing an income tax was not delegated to any other legislative tribunal; the territorial legislature decided the expediency of the law solely by itself and for its own reasons. It remains a law whether Congress legislates or not, and the fact that it incorporates by reference future amendments of the Internal Revenue Code does not constitute an abdication or delegation of legislative power. The reference to future amendments is nothing more than a reference to an extrinsic and contingent

fact by which the amount of the tax may be conceivably changed. Because this extrinsic fact is the action of another legislative body, it does not mean that the discretion and judgment of the other body is substituted for that of the territorial legislature. Rather than being a destruction of the latter's discretion and abridgment of its duties and judgment, this is in itself an exercise of the legislative will. It could not be seriously contended that the legislature could not, by a series of separate acts, follow the changes in the Internal Revenue Code. Then why could it not do so by adopting such future changes in one enactment? Such action is merely an economy to the Territory and a convenience to the taxpayers, and to deny this power to the legislature would seriously curtail the extension of its authority to all rightful subjects of legislation. *People v. Fire Ass'n. of Phila.*, 92 N.Y. 311, 44 Am. Rep. 380 (1883), affirmed in 119 U.S. 110; *Underwood Typewriter Co. v. Chamberlain*, 94 Conn. 47, 108 Atl. 154, 160-161 (1919), affirmed in 254 U.S. 113.

Assuming, however, that references to future amendments of the Internal Revenue Code constitute an invalid delegation of legislative power, the entire Act should not fail since those provisions are clearly separable under Section 15 of the Act. It is entirely reasonable to presume that the legislature would have declared that the tax being the vital objective of the Act would be preserved even though the contingency of future amendment of the Internal Revenue Code may never occur, *Utah Power & Light v. Pfost*, 286 U.S. 165, 184-185 (1932); *Watson v. Buck*, 313 U.S. 387, 396-397 (1940), and once the reference to future

amendments is removed from the Act, then the adoption of the Internal Revenue Code can refer only to that law as it existed at the time the territorial statute was enacted, *Kendal v. U. S.*, 12 Peters 524 (1838), and in that respect such an adoption is valid. *Featherstone v. Norman*, 170 Ga. 370, 153 S.E. 70 (1930).

E. The Act does not delegate legislative authority to the Tax Commissioner.

The provisions of Section 7 D of the Act are not an attempted delegation of legislative judgment and discretion as to what the law shall be, but are merely the conferring of a legitimate discretion on the Tax Commissioner to execute the law in accordance with legislative specifications and policy. The objective of this section of the Act—which is for the benefit of the taxpayer—is clear, that is, to return to the taxpayer any taxes that should not have been paid, and all the Tax Commissioner has is a limited discretion as to the manner of effectuating this legislative policy. This is not a grant of unbridled administrative discretion or an abrogation of legislative will and judgment, but it is rather a reasonable and necessary provision for the taking care of complex administrative details that may arise—the only practicable way in which legislative process would be able to function. *Bowles v. Wellingham*, 321 U.S. 503, 514-516 (1943). If the legislature were forced by meticulous and scientific adjustments to foresee and provide for the myriad situations which may arise in the future in the execution of the Act, and to make rules for each of these situations, then the legislative process would be unduly hampered and would bog down. Necessity fixes a point

beyond which it becomes unreasonable to compel the legislature to prescribe detailed rules. *American Power Co. v. Securities & Exch. Comm.*, 329 U.S. 90, 105 (1946).

F. The Act is not invalid because of indefiniteness and uncertainty.

What has been said above with regard to the incorporation by reference of future amendments of the Internal Revenue Code and of future regulations of the Commissioner of Internal Revenue disposes of the contention that these factors cause the Act to fail on the grounds of indefiniteness and uncertainty. The mere reference to extrinsic facts that may occur in the future cannot deprive the taxpayer of any constitutional right since he will know with certainty at the time the tax is payable what his liability is, and the fact that he may not know this before that time is nothing more than a necessary consequence of a complex government setup. The indefiniteness does not cause a taxpayer to act at his peril or subject himself to a possible invalid penalty with a consequent danger of being deprived of property without due process of law. Cf. *Hy-Grade Provisions Co. v. Sherman*, 266 U.S. 497, 501 (1924); *Champlin Refining Co. v. Corp. Comm. of Okla.*, 286 U.S. 210, 243 (1931). The legislative intent in the Act is clear, and this is not a case where there is such ambiguity that after exhausting every rule of construction, no sensible meaning can be given to a statute. There is absolutely nothing vague or uncertain about this Act. (See *Sutherland Statutory Construction; Horack, 3rd Edition, Volume* 2, §4920.)

Failure to define the word "income" does not cause

the Act to fail because of uncertainty. That word when taken in its context makes the meaning clear, and when that is true, the use of the word without specific definition does not render the statute invalid. *Joseph Triver Corp. v. McNeil*, 363 Ill. 559, 5 N.E. (2nd) 929 (1936). A taxpayer cannot be deprived of any constitutional right by the failure of the legislature to define the word "income" when all that he does is to pay a tax to the Territory equal to 10% of the tax he pays to the Federal government under the Internal Revenue Code and under which law "income" is sufficiently defined. This cannot make computation of the tax uncertain.

II.

THE WITHHOLDING TAX PROVISIONS OF CHAPTER 115, SESSION LAWS OF ALASKA, 1949, ARE VALID AS APPLIED TO SEAMEN.

The Federal statutes relating to seamen's wages contained in the Act of June 7, 1872, c. 322, §32, 17 Stat. 268, as amended, Title 46 USCA § 591 to 605, §682 to 685, contain nothing in their terms prohibiting either the imposition of an income tax on seamen or prohibiting the means of collecting the tax by withholding at the source. There is, therefore, no conflict in express terms between the Alaska Net Income Tax Act and the Federal statutes relating to seamen's wages .

There is also no conflict between the two statutes arising from the nature of the subjects covered by each, and there is no interference with the uniformity of maritime law. Statutes providing for the payment of a seaman's wages in full, 46 USCA 597; prohibiting the advances and allotments of wages, 46 USCA 599;

prohibiting stipulations of seamen whereby they may forfeit their right to a lien upon the ship and deprive themselves of any remedy for recovery of wages, 46 USCA 600; prohibiting the attachment or arrestment or assignment of seamen's wages, 46 USCA 601; and providing for payment of wages of a seaman without any deduction whatever, any contract to the contrary notwithstanding, 46 USCA 605; cannot by any rule of statutory construction be interpreted to mean that because one is a seaman, he is relieved from the obligation imposed upon other citizens to bear his fair share of supporting the government that offers him protection. The purpose and policy of Congress in enacting comprehensive laws relating to seamen has been stated by the courts in different ways; for example, in order to protect the seamen "who as a class are poor, friendless and improvident", *Calmar Steamship Corp. v. Taylor*, 303 U.S. 525, 528 (1937); to protect the individual seaman who was "unable to cope effectively with his employer in bargaining", *Hume v. Moore-McCormack Lines*, 121 F. (2nd) 336, 342 (1941); in order to "maintain a merchant marine for the commercial service and maritime defense of the nation by inducing men to accept employment in an arduous and perilous service", *Calmar Steamship Corp. v. Taylor*, supra; or to prevent the seaman from disposing of his wages by either a voluntary or involuntary assignment, "which would interfere with the remedy in admiralty for the recovery of his wages by condemnation of the ship", *Wilder v. Inter-Island Navigation Co.*, 211 U.S. 239, 248 (1908). These congressional objectives reasonably could not be defeated by the withholding from

the seaman's wages of 10% of the amount that is now withheld from his wages for the Federal income tax. It is not reasonable to assume that the obligation to support government has the necessary effect of exposing a seamen to the danger of improvident contracts or the effect of placing an obstacle in the development of a strong merchant marine service. Thus there is nothing in the payment of an income tax by withholding at its source that is hostile or materially prejudicial to general maritime law, or that has the effect of interfering with the essential uniformity of such law. Congress it may be admitted, has manifested an intention to occupy the entire field so far as the protection of seaman is concerned, but the Alaska Net Income Tax Act in no way encroaches in that field. The congressional purpose can be accomplished even in the presence of the Alaska statute. In dealing with the territorial income tax Act, essential features of an exclusive Federal jurisdiction are not involved. *Just v. Chambers*, 312 U.S. 383, 392 (1941); *Standard Dredging Co. v. Murphy*, 319 U.S. 306 (1942).

III.

THE SEVERABILITY CLAUSE.

The provisions of Section 15 of the Act, the severablity clause, if necessary to be utilized, will prevent the Act from failing in its entirety. This provision reverses the presumption that the legislature intended the Act to be effective as an entirety or not at all, and when the court attempts to ascertain legislative purpose, due consideration must be given to this express legislative declaration. *Elec. Bond & Share Co. v. Securities Exch. Comm.*, 303 U.S. 419, 434 (1937).

Assuming, for the sake of argument, that the Act attempts to delegate legislative functions to Congress and the Commissioner of Internal Revenue, such provisions are not so interwoven with the remainder of the Act that there is any inherent difficulty in separation and enforcement of the remainder and vital portions. There is no warrant for concluding that the legislature would be satisfied to sacrifice an important revenue measure in the event the relatively unimportant future contingencies could not be incorporated into the Act. *Utah Power & Light Co. v. Pfost*, 286 U.S. 165, 185 (1932).

It is, of course, conceivable that future changes in the Internal Revenue Code and regulations of the Commissioner of Internal Revenue might lead to complications in the enforcement of the Act, but such considerations, especially in the absence of facts showing any infringement of appellant's rights, do not furnish sufficient grounds to invalidate the Act. *Santee Mills v. Query*, 122 S.C. 158, 115 S.E. 202, 206 (1922).

IV.

WITHHOLDINGS MADE PURSUANT TO THE ACT OF JANUARY 22, 1949, WERE VALIDATED BY THE ACT OF MARCH 26, 1949.

Even though the District Court has held that the extraordinary session of the legislature which enacted the original income tax law on January 22, 1949, was an authorized session, from which it follows that this law, together with tax withholdings made pursuant thereto, were invalid; yet since the legislature which convened in regular session on January 27, 1949, had the power and authority to do what the extraordinary

session had done, Section 16 of the Act, the ratification by the regular session of the extraordinary session's actions, had the effect of validating the tax withholdings made pursuant to the original statute. A ratification can be made when the party ratifying possesses the power to perform the act ratified. *Marsh v. Fulton County*, 10 Wall 676, 684, 19 L. Ed. 1040, 1042 (1869).

This ratification by the regular session of the legislature was the curing of a statute which was defective not because the subject matter was forbidden by the Constitution or the Organic Act, but because of the mere neglect of some legal formality. The subject matter of the statute being something that the legislature could have authorized previously, the curative statute was, therefore, proper and effective. *Board of Education v. Board of Commissioners*, 183 N.C. 776, 111 S.E. 531-536 (1922); *Anderson County Road Dist. v. Pollard*, 116 Tex. 547, 296 S.W. 1062 (1927); *Sutherland Statutory Construction, Horack's Third Edition*, §2214, 2219.

V.

THE RULE THAT EQUITY WILL DETERMINE ALL QUESTIONS MATERIAL TO A CONTROVERSY IN ORDER TO AFFORD COMPLETE RELIEF IS NO EXCEPTION TO THE RULE THAT THE COURT WILL NOT GIVE ADVISORY OPINIONS IN HYPOTHETICAL CASES.

Although, as a general rule, where equitable jurisdiction has been invoked for injunctive purposes, the court has power to decide all relevant matters in dispute and to award complete relief even though the decree includes that which might be conferred by a court of law, *Porter v. Warner Co.*, 328 U.S. 395, 399

(1945), yet the "relevant matters in dispute" and the relief that "might be conferred by law" presuppose the existence of particular facts with reference to which a decision on constitutionality must be given, and not upon appellant's conception of its duty to all of its employees to challenge the tax on every conceivable ground. Here appellant's assertions that the Act contains unreasonable classifications and is lacking in uniformity are based upon hypothetical contingencies of attempted enforcement of the Act, and not upon a precise set of facts involving specific provisions which have been applied to those who claim to be injured. *Alabama State Federaton of Labor v. McAdory*, 325 U. S. 450, 461-471 (1944). Consequently the court need not consider appellant's contentions that the Act discriminates against taxpayers with no net operating loss deductions, against employees for whom no allocation formula is provided, and against manufacturing and extractive industries.

CONCLUSION

For the foregoing reasons it is respectfully submitted that the Alaska Net Income Tax Act is a lawful exercise of legislative authority, valid in its entirety, and that the decree of the District Court should, therefore, be affirmed.

Respectfully,

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For Appellee.

October, 1949

Chapter 115, Session Laws of Alaska, 1949

* * *

Section 5. TAX ON INDIVIDUALS, FIDUCIARIES, CORPORATIONS AND BANKS.

A. GENERAL RULE. There is hereby levied and there shall be collected and paid for each taxable year upon the net income of every individual (except employees whose sole income in Alaska consists of wages or salary upon which tax has been withheld as referred to in subsection B of this Section), fiduciary, corporation and bank, required to make a return and pay a tax under the Federal income tax law, a tax computed by either one of the following methods:

(1) a tax equal to 10 percent of the total income tax that would be payable for the same taxable year to the United States under the provisions of the Internal Revenue Code without the benefit of the deduction of the tax payable hereunder to the Territory.

(2) a tax equal to 10 percent of that portion of the total income tax that would be payable under the provisions of the Internal Revenue Code without the benefit of the deduction of tax payable hereunder to the Territory, that gross receipts derived from sources within the Territory, payroll and value of tangible property located in the Territory, bears to the total gross receipts from sources within and without the Territory, payroll and value of tangible property within and without the Territory.

(a) DETERMINATION OF GROSS RECEIPTS. Gross receipts from sources within the Territory shall consist of interest, rents, royalties, gains, dividends, all other income and gross income received or derived in

connection with propetry owned or a business or trade carried on and salaries, wages and fees for personal services performed within the Territory. Income received or derived from sales wherever made of goods, wares and merchandise manufactured or orginating in the Territory shall be considered to be a part of gross receipts from sources within the Territory.

(b) DETERMINATION OF PROPERTY AND PAYROLL FACTORS FOR FREIGHT AND PASSENGER CARRIERS. The value of vessels operating on the high seas and compensation of employees engaged in operating such vessels shall be apportioned to the Territory in the ratio which the number of days spent in ports within the Territory bears to the total number of days spent in ports within and without the Territory. The term "days spent in ports" shall not include periods when ships are tied up because of strikes or withheld from the Alaska service for repairs, or because of seasonal reduction in service. Days in ports shall be computed by dividing the aggregate number of hours in all ports by 24. The value of aircraft and automotive vehicles operating as freight and passenger carriers from, to and within the Territory and compensation of employees engaged in such operations, shall be apportioned to the Territory in the ratio which the number of days during which such services are rendered within the Territory bears to the total number of days during which such services are rendered within and without the Territory.

(c) APPORTIONMENT OF TAX BY TAX COMMISSIONER. If the taxpayer, upon petition to the Tax Commissioner, as provided in Section 13 of this

Act, conclusively demonstrates that because of other factors, the method of allocation hereinabove provided, results in a larger tax than in equity and good conscience he should have been required to pay, then the tax shall be determined, allocated and apportioned under such processes and formulas as the Tax Commissioner shall provide, and the Tax Commissioner may promulgate proper apportionment rules and regulations conformable with this Act for general application in similar cases. In the case of two or more organizations, trades or businesses owned or controlled directly or indirectly by the same interest, the Tax Commissioner is authorized to distribute, apportion, or allocate the tax where such action is necessary to prevent evasion of payment.

* * *

Section 7. RETURNS AND PAYMENT OF TAX.

D. OVERPAYMENT, CREDIT AND REFUND. The tax Commissioner is authorized to credit or refund all overpayments of taxes, all taxes erroneously or illegally assessed or collected, all penalties collected without authority, and all taxes that are found unjustly assessed or excessive in amount, or in any manner wrongfully collected. The Tax Commissioner shall by means of rules and regulations specify the manner in which claims for credits or refunds shall be made, including adjustments with persons whose sole income in Alaska consists of wages or salary, prescribe limitations and give notice of allowance or disallowance. These rules and regulations shall be based upon the

provisions of Secs. 321 and 322 of the Internal Revenue Code insofar as such provisions are consistent with other provisions of this Act. When refund is allowed to a taxpayer, same shall be paid out of the general fund on a Territorial warrant issued pursuant to a voucher approved by the Tax Commissioner.

* * *

Section 8. COLLECTION OF INCOME TAX AT SOURCE.

B. REQUIREMENT OF WITHHOLDING. Every employer making payment of wages or salaries shall deduct and withhold a tax in the amount of 10 percent of the tax deducted and withheld under the provisions of subchapter (D), Chapter 9 of the Internal Revenue Code. Every employer making a deduction and withholding as outlined above, shall furnish to the employee upon request a record of the amount of tax withheld from such employee on forms to be prescribed, prepared and furnished by the Tax Commissioner.

* * *

Section 12. ENFORCEMENT.

C. SUSPENSION OF LICENSES. In addition to the other penalties imposed herein, any person authorized to conduct any business by virtue of a license duly issued to him under the laws of Alaska, whether he be a resident or not, shall, if he fails to pay the tax levied under Subsection (A), Section 5 of this Act, suffer suspension of his said license or licenses until the tax imposed by this Act, together with penalties, is paid in full.

* * *

Section 15. SEVERABILITY. If any provision of this Act, or the application thereof to any person or

circumstance is held invalid, the remainder of the Act and such application to other persons or circumstances shall not be affected thereby.

* * *

Section 16. REPEALS. The tax contained in subsection 3rd of Sec. 35-1-11 ACLA 1949, which reads as follows: "three quarters of one percent of the net profits from supplies sold" is hereby repealed; and the unnumbered paragraph between subsections (f) and (g) of subsection 7th of Sec. 35-1-11 ACLA 1949, which imposes a net income tax on canneries, is hereby repealed; and the tax contained in House Bill No. 1 of the Extraordinary Session of the Nineteenth Legislature, which will become Ch. 3 of the Session Laws of said session, is also hereby repealed, but tax withholdings effectuated and other administrative steps taken thereunder are hereby ratified and confirmed and made applicable hereunder so far as conformable with the provisions hereof.

APPENDIX B

Act of Aug. 24, 1912, c. 387, §9, 37 Stat. 514, 48 USCA 77.

The legislative power of the Territory of Alaska shall extend to all rightful subjects of legislation not inconsistent with the Constitution and laws of the United States . . . . .

Act of Aug. 24, 1912, c. 387, §9, 37 Stat. 514, 48 USCA 78.

All taxes shall be uniform upon the same class of subjects and shall be levied and collected under general laws, and the assessments shall be according to the actual value thereof.

No. 12,298

In the United States Court of Appeals for the Ninth Circuit

ALASKA STEAMSHIP COMPANY, A CORPORATION, APPELLANT

v.

M. P. MULLANEY, COMMISSIONER OF TAXATION, TERRITORY OF ALASKA, APPELLEE

ON APPEAL FROM THE DISTRICT COURT FOR THE TERRITORY OF ALASKA, DIVISION NUMBER ONE

BRIEF FOR THE UNITED STATES AS AMICUS CURIAE

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THE INTEREST OF THE UNITED STATES

Under date of August 4, 1949, the Court granted leave to the United States to file a brief herein as *amicus curiae.*

This brief is filed to protect the interests of the United States. The Territory of Alaska has budgeted and incurred obligations in anticipation of the revenues to be derived from the tax on income during the calendar year 1949, imposed by the "Alaska Net Income Tax Act" (Session Laws of Alaska (1949) c. 115), assailed by plaintiff-appellant, Alaska Steamship Company, on this appeal. Invalidation of this statute will

seriously and adversely affect the whole economy of the Territory and immeasurably cripple the functions of the Territorial Government; the whole range of governmental services, from the maintenance of law and order to the safeguarding of public health, would be affected; territorial revenues would be considerably less than territorial obligations and expenditures; the United States Department of the Interior might be compelled to seek an appropriation from Congress to meet the deficit. Thus, the United States possesses an important financial interest in the outcome of this litigation.

Moreover, the paramount interest of the United States in the maintenance of good government and law and order in its territories is self-evident. The Constitution imposes an obligation upon the United States of guaranteeing the maintenance of law and order in the states themselves. Article IV, Section 4. The force and immediacy of such an obligation upon the United States is even clearer in the case of one of its possessions. The United States has thus, on this ground alone, an important and direct interest in the outcome of this litigation.

Furthermore, the instant litigation raises fundamental questions with respect to the extent of the authority possessed by the legislature of the Territory of Alaska under the Constitution and the Organic Act of Alaska. Act of August 24, 1912, c. 387, 37 Stat. 512, as amended. The correct determination of these questions of constitutional and organic law represents a further important interest of the United States in the outcome of this litigation.

It is for these compelling reasons that the Government of the United States appears in this case as *amicus curiae.*

OPINION BELOW

The opinion of the District Court for the Territory of Alaska, Division Number One (R. 44-60) is reported in 84 F. Supp. 561.

QUESTIONS PRESENTED

1. Whether Chapter 115, Session Laws of Alaska, 1949, known as the Alaska Net Income Tax Act, imposing a net income tax, is a valid exercise of the taxing authority of the Territory.

2. Whether, if some provisions of the Alaska Net Income Tax Act are invalid, the remainder of the Act may be given effect.

CONSTITUTIONAL PROVISIONS AND STATUTES INVOLVED

The constitutional provisions and statutes involved are set forth in the Appendix, *infra.*

STATEMENT

The District Court made the following findings of fact:

Plaintiff-appellant, Alaska Steamship Company, hereinafter sometimes denoted as "the corporation", is a corporation organized under the laws of the State of Washington with its principal place of business at Seattle, and qualified to do business in the Territory of Alaska. Defendant-appellee Mullaney is the Commissioner of Taxation for the Territory of Alaska and will usually be denoted below as "Commissioner". The instant action arises under the Territorial Act approved March 26, 1949, designated as "Alaska Net Income Tax Act" (being Chapter 115 of the Session Laws of Alaska (1949)), and which will usually be referred to herein as "the Income Tax Act". (R. 62.)

The corporation engaged in interstate commerce in the operation of a line of vessels transporting freight

and passengers between Seattle and all principal ports of the Territory of Alaska. For approximately 75% of the time spent on voyages the corporation's vessels are in territorial waters and in waters off shore from the coast of Alaska; part of the voyages are made through Canadian waters and part outside the three mile limit off the Alaskan coast. In this trade at all times the corporation operates at least twelve vessels. At the time of the trial of this case in April, 1949, the corporation employed approximately 706 seamen who were nonresidents of the Territory. The seamen belong to various unions including the Sailors Union of the Pacific, and are employed under union contracts and paid off in Seattle at the end of each voyage upon the return of the vessels to Seattle, in accordance with the union scale and the union contract. (R. 62-63.)

Under the provisions of the Alaska Net Income Tax Act, the corporation has deducted the sum of $7,339.75 from the wages of seamen for the quarter ending March 31, 1949. Preliminary injunctions issued on February 4 and April 4, 1949, by the United States District Court for the Western District of Washington, Northern Division, in a suit brought by John E. Humes, Bob Domtroff, and Sailors Union of the Pacific against the corporation, ordered the corporation to withhold the tax from the wages of its seamen and personnel of its vessels and to deposit the amount so withheld in a special fund subject to the order of that court, and prohibited the corporation from paying any portion to the Commissioner. (R. 64.)

In addition, the corporation employed nineteen resident Alaskans who are agents, assistant agents and shore employees. The Alaska income tax on their wages was withheld from the period commencing January 1, 1949, until the end of the March quarter, amounting to $2,319.96. This sum was impounded pursuant to the

order of the court below (R. 64), which directed the corporation, pending final determination of the instant case, to pay into the court below all amounts withheld from the salaries of resident Alaskans (R. 42-43). The Commissioner demanded that the corporation pay the withholding tax imposed by the Act and the corporation had no adequate remedy pending the decision in the court below except by means of the preliminary injunction which that court issued. (R. 65.)

The Extraordinary Session of the Territorial Legislature which convened on January 6, 1949, and which passed an Income Tax Act on January 22, 1949 (Chapter 3 of Session Laws of Alaska (1949)), was composed of members who, with the exception of long term members elected in October, 1946, were elected in October, 1948, and whose terms would not commence until the convening of the legislature in regular session on January 27, 1949. Further, the terms of the members who were elected in October, 1946, and of the regular term members elected in 1944 who took their seats on the fourth Monday of January, 1947, did not expire until the convening of the legislature in regular session on January 27, 1949, and they should have composed the membership of the Extraordinary Session which was convened on January 6, 1949. (R. 65.)

The regular session of the 1949 Territorial Legislature reenacted the Alaska Net Income Tax Act as Chapter 115, Session Laws of Alaska (1949), approved March 26, 1949, and in accordance with its Section 16 the tax withholdings effectuated under the Act passed by the Extraordinary Session in January were ratified and confirmed. (R .66.)

The term "Continental Shelf" as used in Section 5 B(1) of the Income Tax Act in the clause "including the waters over the continental shelf", although indefinite in its use, may, under the severability provisions

of the Act (Section 15), be eliminated without affecting the remainder of the Act. (R. 66.)

The evidence and pleadings do not show that there has been any amendment of either the United States Internal Revenue Code or the Regulations promulgated by the United States Commissioner of Internal Revenue since the enactment of Chapter 115, Session Laws of Alaska (1949). (R. 66.)

On the basis of the foregoing, the District Court concluded that the Income Tax Act, c. 115, Session Laws of Alaska (1949), is a valid Act and the temporary injunction, which it had issued, should be vacated and the complaint dismissed. (R. 67.) Further, while the Act (Chapter 3) passed by the Extraordinary Session is invalid, since that body was not constituted in accordance with law, the tax withholdings made pursuant to it are valid under Section 16 of the later Act. (R. 66-67.)

Accordingly, on July 8, 1949, judgment was entered dismissing the complaint and vacating the preliminary injunction. (R. 68-69.)

SUMMARY OF ARGUMENT

A. The Organic Act vested the Legislature of Alaska with the plenary taxing power of Congress over the Territory. The general power to legislate and the full power to tax were conferred in language sweeping and comprehensive in character. Legislation enacted by the Territorial Legislature under this unlimited power expressly given can only be held violative of the Constitution when palpably arbitrary.

B. The challenged statute does not improperly delegate to Congress the legislative power of the Territory. The manifest design of the territorial income tax is to take the federal income tax as the starting point and to impose in general a tax equal to 10% of the federal income tax. Returns are required from the same persons

and at the same time as federal income tax returns; and in the case of employees, are collected by salary deduction and withholding under the same circumstances as under the Internal Revenue Code. Thus, the employer is required merely to withhold for the Alaskan tax 10% of the federal tax withholding.

No amendment of the Federal Act was established subsequent to the enactment of the Territorial Act, and hence, so far as the instant record is concerned, the territorial tax here involved adopted by reference only *existing* federal law. Hence, in this state of the record, appellant's principal point of objection, namely, that the territorial statute incorporated by reference prospective amendments to the Internal Revenue Code made by Congress, was correctly held unavailable by the court below. The instant record does not appropriately present such a question and it is a familiar principle that a statute will not be ruled unconstitutional or otherwise in contravention of fundamental law upon a hypothetical state of facts. The decision of the alleged issue of fundamental law by this Court could involve no legal consequence for either appellant or its employees here. One, who would strike down a statute as unconstitutional, must show that the alleged unconstitutional feature injures him; he is not the champion of any rights except his own.

In any event, the adoption by the Legislature in this statute of continued federal-territorial income tax uniformity as a territorial policy constituted no invalid delegation. Whatever the rule with reference to alleged application of legislative power involved in state legislation adopting by reference prospective federal legislation, there can be no constitutional objection to action by the Territorial Legislature, the agent of Congress, in delegating back to Congress, its creator, the authority originally received from Congress.

Again, the Legislature has not left to Congress or others the solution of the tax problem before it, but by the challenged statute has itself devised a remedy reasonably calculated to meet the peculiar situation confronting it. The practical advantages of simplicity and economy in administration and the large savings in time and money both to the Territory and its taxpayers derived from a uniform federal territorial tax system are clear, especially to Alaska with its vast area and widely scattered population. Indeed, the urgent need for coordination between federal and state governments in the income tax field has focused attention in recent years. Avoidance of the serious evils arising from lack of uniformity seems called for even more plainly in the case of an income tax imposed by a federal dependency. As a matter of fact, the Income Tax Act did not expressly make any delegation to Congress; and the statutory reference is to an external standard, namely, the Internal Revenue Code as now in effect or hereafter amended. The Legislature might reasonably deem it in the public welfare to adopt as its policy a program for keeping the local requirements exactly in pace with the federal. The Legislature has not abandoned any real control of the terms or rate of tax, and the rule established in the challenged statute is sufficiently precise and definite in practice and in the light of federal income tax history and the retained power of correction. Artificial conceptualism aside, the future action of Congress upon the federal income tax between sessions of the Alaskan Legislature is an external event, which the Legislature might here in the public interest reasonably risk to obtain the enormous benefits from uniformity.

No legislature is continuously in session and the risk is always present that, as a practical matter, before it reconvenes the law for the time being may cease to re-

flect its will, as a result of intervening events or the acts of others. The Legislature has not abandoned any of its essential powers.

C. The challenged statute does not improperly delegate to the United States Commissioner of Internal Revenue the legislative power of the Territory. The mere fact that the Legislature chose to vest the power to fill in details in the statute in an appropriate federal rather than territorial official does not in itself invalidate the statute. Indeed, such authority may on occasion properly be conferred upon even a private body. Besides, the statute vests full discretion in the Territorial Tax Commissioner to reject the federal and promulgate in lieu thereof local regulations. Finally, there was no showing in this record that any federal Regulations, not in existence at the time of the approval of the territorial statute, are applicable to the rights of any taxpayer involved in this litigation.

The statute stated intelligible principles or standards reasonably clear whereby administrative discretion must be governed, and, hence, made no improper delegation to the Territorial Commissioner of Taxation.

D. The statutory provisions for adoption by reference of future amendments to the Internal Revenue Code do not cause the statute to be void for indefiniteness or uncertainty. The Alaskan tax is no more invalid for this reason than is the federal income tax with which it is coordinated.

E. The uniformity clause of the Organic Act of Alaska does not forbid the imposition of a graduated income tax. The uniformity clause imposes geographic not intrinsic uniformity. In view of the full power of taxation which Congress proposed to vest in the Legislature, a construction of the Organic Act, which would

deny to Alaska the power to impose a progressive income tax and to gauge income tax liability in accordance with ability to pay, is unreasonable. It is unlikely that Congress intended to grant less power in this respect to the Legislature of Alaska than to the Legislatures of the sister dependencies of Hawaii and Puerto Rico, where graduated income taxes have long been levied.

F. The classifications made by the statute were well within the area of legislative discretion, and were not arbitrary nor in denial of due process. Appellant has not sustained the heavy burden of negativing every conceivable basis which might support the classifications provided in the statute. Again, these questions as, for example, with respect to the apportionment formulae, which appellant seeks to raise, are not presented by the instant record at all.

G. Forfeiture of licenses granted by the Territory might validly be imposed as a sanction to assist in collection of past due territorial taxes. However, the record does not present this question either.

H. Ratification in the instant Act of the withholdings made under the repealed Chapter 3 of the Session Laws of Alaska was within the legislative power. The taxes withheld were due retroactivly under the terms of the valid instant statute, and no adequate reason appears why the Legislature could not in the exercise of its discretion ratify and confirm such prior withholdings in collection of the instant tax.

I. The withholding provisions on wages of seamen are not in conflict with congressional legislation. The familiar device for collecting income taxes by requiring an employer to deduct and withhold the tax from wages

does not fall within the meaning of an attachment or arrestment from any court.

J. In any event, the Legislature intended the valid provisions of the statute to be severable from the provisions alleged here to be invalid. It is not reasonable, for example, to suppose the Legislature would have vitiated the entire income tax for the year 1949 in the event it should be held that prospective changes in the Internal Revenue Code could not properly be adopted in the Alaskan Act, and thereby imperil the support and operation of the Territorial government. Moreover, appellant has no standing here to raise an alleged issue of non-severability, for it cannot show that it has been injured by any purportedly invalid part of the statute.

ARGUMENT

The challenged provisions of the Alaska Net Income Tax Act (C. 115, Session Laws of Alaska (1949)) constitute a valid exercise of the taxing authority of the Territory

A. *The Organic Act vested the Legislature of Alaska with the plenary taxing power of Congress over the Territory*

The Organic Act of Alaska (Act of August 24, 1912), c. 387, 37 Stat. 512, was intended to confer upon the organized Territorial Government of Alaska, an autonomy similar to that of the states and full power of local self-government. The power of taxation, the power to enact and enforce laws, and other characteristic governmental powers were vested. A typical American governmental structure was erected; a body politic—a commonwealth—was created. Cf. *Puerto Rico* v. *Shell Co.,* 302 U. S. 253, 261-262.

The general power to legislate and the full power to tax were conferred in language sweeping and comprehensive in character. Thus, Section 4 provided (Appendix, *infra*) "the legislative power and authority of

said Territory shall be vested in a legislature," and Section 9 read broadly (Appendix, *infra*): "The legislative power of the Territory shall extend to all rightful subjects of legislation not inconsistent with the Constitution and laws of the United States". Moreover, the earlier Section 3 (Appendix, *infra*), made clear the intent to include existing territorial law among such "rightful subjects of legislation", as follows:

> except as herein provided all laws now in force in Alaska shall continue in full force and effect until altered, amended, or repealed by Congress *or by the legislature*: (Italics supplied)

and again, the same section expressly referred to (Appendix, *infra*), "the authority herein granted to the legislature to alter, amend, modify, and repeal laws in force in Alaska", excluding (with exceptions here immaterial) only the customs, internal-revenue, postal, or other general laws of the United States. Further, it is here significant that these stated limitations against amendment or repeal of federal taxes were explicitly not to restrict the authority to impose local taxes, for the same Section 3 (Appendix, *infra*): "*Provided further,* That this provision shall not operate to prevent the legislature from imposing other and additional taxes or licenses."

In *Alaska Fish Co.* v. *Smith,* 255 U. S. 44, 49, Mr. Justice Holmes, speaking for the Supreme Court, sustaining a taxing act passed by the Legislature of Alaska, declared that under the Organic Act "the legislature has the full power of taxation" and, construing Section 3, *supra,* took "into account the express and unlimited authority to impose additional taxes and licenses". Again, in another case, Mr. Justice Holmes, speaking for the Court, subsequently characterized the power to tax conferred under the Organic Act as "the unlimited

power expressly given". *Pacific Fisheries* v. *Alaska,* 269 U. S. 269, 277.

It follows that the holding of this Court in *Kitagawa* v. *Shipman,* 54 F. 2d 313, certiorari denied, 286 U. S. 543, with respect to taxing acts passed by the Legislature of Hawaii applies equally to the Alaskan Act here, as follows (p. 318):

> When Congress gave full legislative authority to the state Legislature of the Territory of Hawaii to legislate upon "all rightful subjects of legislation not inconsistent with the Constitution and laws of the United States locally applicable" (see 48 USCA § 562), it vested in the Legislature of Hawaii *the full taxing power which had theretofore existed in Congress over that Territory,* and the legislation enacted by the territorial Legislature under this delegated power can only be held violative of the Constitution of the United States when palpably arbitrary. (Italics supplied.)

Accordingly, the statute here challenged was passed in exercise of a legislative power identical with the full power to tax inherent in Congress over a territory, and upon appellant rests the heavy burden of negativing every conceivable basis which might support the tax even in the exercise of so plenary an authority.

B. *The challenged statute does not improperly delegate to Congress the legislative power of the Territory*

The tax in issue is the first general Territorial income tax which Alaska has imposed.[1] Previously there were, however, the license taxes computed on income, quoted

[1] As already noted, the instant statute repealed the similar income tax imposed on January 22, 1949 (c. 3, Session Laws of Alaska (1949)), but ratified tax withholdings and other administrative steps taken under the prior statute (Section 16, Appendix, *infra*), and is similarly applicable for taxable years commencing January 1, 1949 (Section 4).

in the footnote,[2] repealed by the instant Act (Section 16, Appendix, *infra*) and a "sales profits tax" of 1% levied upon all profits in excess of $1,000 upon sales of real estate and other capital assets. 1 Alaska Compiled Laws Annotated (1949), Sections 48-6-1 to 48-6-5.

The design of the Territorial Income Tax Act is manifest; the federal income tax is taken as the starting point and the Territory imposes in general (Section 5 A. (1), Appendix, *infra*);

> (1) a tax equal to 10 percent of the total income tax that would be payable for the same taxable year to the United States under the provisions of the Internal Revenue Code without the benefit of the deduction of the tax payable hereunder to the Territory.

Returns are required from the same persons and at the same time as the federal income tax returns (Section 7

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[2] 1 Alaska Compiled Laws Annotated (1949):

§ 35-1-11. *Businesses, professions or callings requiring license: Amount of license.* * * *

3rd. *Any person, firm or corporation selling electricity for light, power and other purposes and/or steam for heating purposes and supplies therefor, three-fourths of one percent. of the gross receipts in excess of twenty-five hundred dollars per annum from light, power and steam sold;* three-fourths of one percent. of the net profits from supplies sold, but this tax shall not apply to plants owned by municipalities. (Italics supplied; italicized matter not repealed.)

* * * * *

7th. *Fisheries:*

* * * * *

(f) * * *

In addition to the above tax, salmon canneries shall pay one percent. of their net annual income. The net income shall be determined in the same manner as the net income is determined under the Federal Income Tax Law, except that no deduction shall be allowed on account of interest on bonds or money borrowed except on account of other Territorial taxes paid.

A, Appendix, *infra*), and Section 7 B (Appendix, *infra*) states:

> * * * The total amount of tax imposed by this Act shall be due and payable to the Tax Commissioner at the same time and in the same manner as the tax payable to the United States Collector of Internal Revenue under the provisions of Section 56 of the Internal Revenue Code.

In the case of employees, such as the taxpayers instantly involved, whose federal income tax is collected by withholding under subchapter (D) of Chapter 9 of the Internal Revenue Code, Alaska similarly imposes by withholding, 10% of the federal salary deduction, as follows (Section 5 B, Appendix, *infra*):

> * * * There is hereby levied upon and there shall be collected from every employee (including persons referred to in subsection (C) of Section 1621 of the Internal Revenue Code) whose sole income in Alaska during the taxable year consists of wages or salary, a tax in the amount of ten percent of the tax deducted and withheld under the provisions of sub-chapter (D), Chapter 9, of the Internal Revenue Code, which tax is to be withheld by the employer under the provisions of Section 8 of this Act. * * *

The correlative duty to deduct at the source 10% of the federal income tax withheld from wages or salary payments is imposed on the employer, such as appellant here. Section 8 B (Appendix, *infra*).

The practical advantages of simplicity and economy both to the Territory and to taxpayers inherent in this statutory plan are clear: to the taxpayers, large savings in time and money in preparation of returns; to the Territory great economy in cost of administration, which in the last analysis also redounds to the taxpayers. As a further important salutary incident, only one audit

for both taxes becomes requisite. See Section 7 C (Appendix, *infra*), quoted in the footnote.[3] Besides, the meaning established in the federal law for many terms and concepts, after years of litigation, is gained without more for the local law.

The Territorial statute defines the Internal Revenue Code, which it thus incorporates, as follows (Sections 3 A (8), and B, Appendix, *infra*):

> Section 3. DEFINITIONS.
>
> A. IN GENERAL: For the purpose of this Act—
>
> * * *
>
> (8) The words "Internal Revenue Code" mean the Internal Revenue Code of the United States (53 Stat. 1) as amended or as hereafter amended.
>
> * * *
>
> B. REFERENCES TO INTERNAL REVENUE CODE.
>
> (1) Whenever the Internal Revenue Code is mentioned in this Act, the particular portions or provisions thereof, as now in effect or hereafter amended, which are referred to, shall be regarded as incorporated in this Act by such reference and shall have effect as though fully set forth herein.
>
> (2) Whenever any portion of the Internal Revenue Code incorporated by reference as provided

---

[3] Section 7. RETURNS AND PAYMENT OF TAX.

* * * * *

C. FEDERAL INCOME TAX RETURN. Any taxpayer, upon request by the Tax Commissioner, must furnish to the Tax Commissioner a true and correct copy of any tax return which he has filed with the United States Collector of Internal Revenue. Every taxpayer must notify the Tax Commissioner in writing of any alteration in, or modification of, his Federal income tax return and of any recomputation of tax or determination of deficiency (whether with or without assessment). A full statement of the facts shall accompany this notice, which must be filed within twenty days after such modification, recomputation or determination of deficiency, and the taxpayer must pay the additional tax or penalty hereunder.

> in Paragraph (1) of this subsection refers to rules and regulations promulgated by the United States Commissioner of Internal Revenue, or hereafter so promulgated, they shall be regarded as regulations promulgated by the Tax Commissioner under and in accord with the provisions of this Act, unless and until the Tax Commissioner promulgates specific regulations in lieu thereof conformable with this Act.

1. *The Territorial tax here levied adopted by reference only existing federal law*

It is in these provisions last quoted that appellant principally finds the alleged improper delegation of legislative authority by the Territorial Legislature, in that thereby the Territorial Act incorporated assertedly not merely the terms of the federal Internal Revenue Code existing at the time of the passage of the Alaskan Act, but amendments to the federal legislation which may be adopted in the future. (Br. 14-18.) As a matter of fact, however, subsequent to the enactment of the challenged Act, as the court below found, no such amendment of the federal Act was established. (R. 53, 66.) Hence, as the District Court further recognized, the case here is simply one of incorporation by reference of the pre-existing law which indisputably involves no improper delegation. *Franklin* v. *United States,* 216 U. S. 559, 568-569; *Santee Mills* v. *Query,* 122 S. C. 159, 115 S. E. 202. As explained by the Supreme Court of Georgia sustaining in *Featherstone* v. *Norman,* 170 Ga. 370, 395, 153 S. E. 58, a Georgia income tax of like design:

> It makes a class of income taxpayers composed of persons who have a net income equal to that fixed by the general government, and levies a tax on such income equal to thirty-three and one third per cent. of that which Congress levies on net income under the United States income-tax statute.

> All this is the handiwork of the Georgia legislature. In this work Congress takes no hand. So this act in no way delegates to Congress the legislative power of the State. If the legislature had adopted all the features of the Federal act, this would not be delegating its power to Congress. By the act of 1784, the Georgia legislature adopted the common law of England and such of the statute laws of that country as were usually in force in the province of Georgia on May 14, 1776. Cobb's Digest, 775. This did not in any way delegate to England the legislative power of Georgia. * * *

Again, in this state of the record appellant's principal point of objection was correctly held unavailable by the court below. (R. 53.) A statute will not be ruled invalid as unconstitutional or otherwise in contravention of fundamental law upon a hypothetical state of facts. Thus, the Supreme Court held in *Tennessee Pub. Co.* v. *Amer. Bank,* 299 U. S. 18, 22:

> It is a familiar rule that the court will not anticipate the decision of a constitutional question upon a record which does not appropriately present it. *Liverpool, N.Y. & P.S.S. Co.* v. *Commissioner,* 113 U. S. 33, 39; *Cincinnati* v. *Vester,* 281 U. S. 439, 448, 449; *Arizona* v. *California,* 283 U. S. 423, 463, 464.

Appellant's employees were not prejudiced by the alleged invalid provisions since these were not enforced in this case, there having been no amendments of the incorporated federal legislation made or applicable to them subsequent to enactment of the Territorial Act. The decision of the alleged issue of fundamental law by this Court, which appellant seeks to raise, could involve no legal consequences for the parties here. One who would strike down a statute as unconstitutional must show that the alleged unconstitutional feature injures him. *Premier-Pabst Co.* v. *Grosscup.* 298

U. S. 226, 227. The identical point was made in *Commonwealth* v. *Alderman,* 275 Pa. 483, 487, 119 Atl. 551, which also involved incorporation in a state statute by reference of future as well as present federal legislation.

Appellant further urges that the allegedly invalid provisions incorporating future changes in the Internal Revenue Code are not separable from the valid. (Br. 32-34.) This contention, which seems plainly unsound, is discussed, *infra,* in subpoint J. Indeed, appellant has no standing here to raise an alleged issue of severability for, as already explained, the purportedly invalid portion does not hurt appellant or its employees and there will be time enough to consider complaints on ground of nonseverability after a person injured by the alleged invalid portion has come forward with request for relief. *Yazoo & Miss. R. R.* v. *Jackson Vinegar Co.,* 226 U. S. 217, 219-220; *Dollar Co.* v. *Canadian C. & F. Co.,* 220 N. Y. 270, 282-283, 115 N. E. 711. "The plaintiffs are not the champions of any rights except their own." *Henneford* v. *Silas Mason Co.,* 300 U. S. 577, 583.

2. *In any event, the adoption by the Legislature in this statute of constant federal-territorial income tax uniformity as a territorial policy constitutes no invalid delegation*

In any event, the lower court correctly held the statute, as written, to constitute no improper delegation. (R. 53.) For present purposes it is not disputed that the taxing power which Congress by the Organic Act conferred upon the Legislature was intended to be exercised by the Legislature, that the actual abdication or transfer of this power to a third party would *pro tanto* effect an alteration in the prescribed frame of the Territorial Government contrary to the con-

gressional mandate. Here, however, it is noteworthy that strictly a federal statute and not a Constitution is claimed to have been infringed, a statute, whose source was not the People (as would be true in the case of a Constitution) but the very agency, namely, Congress, to whom it is asserted an improper delegation was made. Yet Congress may, as a matter of course, at any time alter and amend its creature, the Organic Act, and itself directly exercise legislative power over the Territory. Hence, such exercise following "delegation" to it by the Territorial Legislature could effectually ratify and validate any *pro tanto* modification by the Legislature of the Organic statute implicit in the hypothetical "delegation". Indeed, this reasoning was adopted by the Supreme Court of Puerto Rico as one of its grounds in sustaining the insular Emergency Price Control Act, where in *Irizarry* v. *District Court,* 64 P.R.R. 90, 101 (English ed.), (also reported unofficially in 2 Pike and Fischer OPA Opinions and Decisions 2196 (decided July 28, 1944)), it said:

> In addition, it might well be urged that, whatever the rule with reference to the alleged abdication of sovereignty involved in state legislation adopting by reference prospective Federal legislation, there may be no constitutional objection, to action by the Legislature of Puerto Rico, the agent of Congress, in delegating back to Congress, its creator, the authority to legislate it originally received from Congress.

See also *United States* v. *Heinszen & Co.,* 206 U. S. 370, 382-385. As a matter of fact, Congress in the Organic Act retained expressly supervisory power over territorial legislation (Section 20, Appendix, *infra*):

> Sec. 20. Laws Shall be Submitted to Congress. —That all laws passed by the Legislature of the Territory of Alaska shall be submitted to the Congress by the President of the United States,

and, if disapproved by Congress, they shall be null and of no effect.

Again, from another aspect the question here presented is whether the Legislature has left to Congress or others the solution of the tax problem before it, or, on the other hand, has by the challenged statute itself devised a remedy reasonably calculated to meet the situation confronting it. The answer requires first of all, an analysis of the problem which the Legislature faced in framing the income tax. The vast Territory, approximating 585,000 miles in extent and the widely scattered population numbering upwards of 75,000, presented obvious and serious difficulties in administration and collection, but substantially identical with those with which the federal income tax administration had for thirty years been coping. Since the Territorial tax was only one tenth of the federal, economy in administration was the more essential. The advantages to all concerned in economy and simplicity which are derived by virtue of uniformity with federal income tax administration have already been stated. Surely the Legislature has not here made an arbitrary choice but, on the contrary, an eminently reasonable one.

Indeed, the urgent need for coordination between the federal and state governments in the income tax field has been the subject of much thought and discussion in recent years. A detailed history through 1942 of the movement for intergovernmental fiscal coordination in the United States is contained in a report on "Federal, State, and Local Fiscal Relations" submitted to the Secretary of the Treasury by a special committee designated to conduct a study on that subject and transmitted to the Senate by that body's own direction. S. Doc. No. 69, 78th Cong., 1st Sess. In this significant report coordination in federal and state income taxation was regarded "of first importance" (p. 417), and

efforts towards uniform laws and joint returns suggested (pp. 148-149):

> At one time Federal officials and those of New York State attempted to work out a joint Federal-State income tax return. But no very serious effort was made and the negotiators appear to have been easily discouraged. Similar efforts in Canada proved successful in the case of four Provinces with results reported to be eminently satisfactory. Such joint returns require a substantially uniform definition of income, but permit variations in exemptions, deductions, and rates. State laws differ from Federal and from each other in a few important respects and in many insignificant details. But there is also a very large amount of common ground. Were a few States to achieve a working arrangement with joint returns, it seems reasonable to assume that others would follow, and also that a movement towards uniformity in definition would receive a very powerful impetus.

Elimination of dual administration was recommended (p. 452):

> By far the most promising approach to coordination in the income-tax field is from the angle of administration. * * * Some cooperation has already been achieved in the United States. Utilization by the States of Federal income-tax information is already developed to some extent and some informal cooperation between administrative staffs now occurs. But the field has scarcely been scratched. Joint returns, joint audits, joint use of personnel, more uniform laws, are a few of the possibilities. As previously suggested, a Federal-State Fiscal Authority could do much to facilitate development in this field. Moreover, the broad jurisdictional authority and administrative facilities of the Federal Government are needed, also, to uncover and to levy upon many income sources currently escaping taxation.

The Treasury carried this study forward to July, 1947, in a sequel entitled "Federal-State Tax Coordination" which was printed in the report of the House Hearings before the Committee on Ways and Means, Revenue Revisions, 1947-1948, Part 5, pp. 3676-3706, where the following pertinent statements appear (pp. 3677, 3678-3679):

> The widespread use of the income tax by the Federal Government and the States and its occasional use at local levels has focused attention on the need for intergovernmental coordination in this field. In recent years the income tax has become the most important single source of Federal revenue and is an important source of State revenue as well. * * *
>
> The imposition of duplicate levies on the same tax base, aside from adding to the tax burden, increases the cost of taxpayers' compliance (particularly for corporate taxpayers) and involves duplicate administrative costs for the taxing governments.
>
> * * * * *
>
> Another factor which has made for coordination of Federal and State income taxes is the adoption of similar definitions of tax bases. While there are incidental variations which suffice to complicate appreciably the compliance problems of taxpayers, definitions of net taxable income in the several States do not on the whole differ markedly from one another or from the Federal definition. Several States use the Federal definition of "net income" for corporate tax purposes, with certain adjustments. The progressive individual income tax enacted by Vermont this year adopts the Federal definition of "net income" with certain adjustments, e.g., the exclusion of income expressly exempted from taxation by the States and the exclusion of capital gains and losses. It also adopts the Federal system of personal exemptions ($500 each for the taxpayer, his spouse, and each

> of his dependents), and uses the Federal definition of "dependent." The Federal definition of "adjusted gross income" is used (except for exclusion of capital gains and losses) and an optional simplified tax table is provided for all persons whose adjusted gross income is less than $5,000.
>
> The adoption of uniform definitions of income by the States and the Federal Government would make the use of a joint Federal-State income tax return practicable. This would also clear the way for single administration of Federal and State taxes in the event that it was desired to eliminate duplicate administration. It should be kept in mind that the use of the same tax base and the same tax return would not necessarily require the various States to impose similar tax rates. Each State could continue to adjust its rates and exemptions to suit its own revenue needs.
>
> In some cases, present differences between the Federal and the State tax bases are so small as to suggest that uniformity could be quite readily obtained. * * *

A thoughtful article by the experienced Deputy Commissioner and Counsel to the New York State Department of Taxation and Finance has recently summarized the advantages of uniformity (Kassell, No Uniformity in State Income Taxes—Why? 87 Journal of Accountancy 293, 296 (April, 1949)):

> There are many obvious advantages to a state adopting federal net income as a starting point in determining its personal income taxes:
>
> (1) From the states' standpoint, there would be great savings in the cost of tax administration and probably increased revenue.
>
> (2) From the taxpayers' standpoint, there would be great economies in the preparation of returns.
>
> (3) There would be one rather than possibly 49 separate bodies of law on the same subject matter,

with the consequent avoidance of duplicate litigation.

(4) There could be one audit rather than many.

(5) Returns would be more complete and correct.

Mr. Kassell suggests the creation of a federal-state agency by way of remedy to deal with the problems arising from lack of uniformity in income tax laws, which (p. 297)—

> might eventually get to joint returns, joint audits, and possibly even administration of overlapping taxes.
>
> * * * * *
>
> I believe that unless the federal and state governments cooperate in this field *inefficiency in tax administration and unnecessary hardship on taxpayers will be continued.* * * * (Italics supplied.)

Avoidance of such evils, arising from lack of uniformity, seems called for even more clearly in the case of an income tax imposed by a federal dependency. Here by the challenged statute the Territorial Legislature has actually molded a specific against the very evils of inefficiency, wastefulness and unnecessary hardship to taxpayers resulting from divergent federal and local income tax systems, and against which those expert in the field of tax administration have, as we have seen, inveighed for many years. The instant statutory design represents a typical exercise of the legislative prerogative, flexibly to custom tailor the rule to suit the particular case, whose circumstances, as above noted, of vast territory and thinly spread population would inevitably exaggerate the wastefulness of divergent income tax systems. To assert that such constructive accomplishment exhibits negation of legislative power seems ironical. It is submitted the Court should be loathe to follow appellant's sug-

gestion to undo this beneficial legislative plan through a wooden and conceptualistic application of a constitutional aphorism.

As a matter of fact, the asserted delegation is completely the creature of appellant's inference; the Income Tax Act, as the lower court observed (R. 52), did not expressly make any delegation to Congress. The statutory reference is to an external standard, namely, the Internal Revenue Code "as now in effect or hereafter amended". Section 3 B (1). It is submitted in the light of the practical situation under which the Legislature labored, this provision did not effect a substitution of congressional discretion for its own, but the challenged statute itself laid down a sufficiently precise rule. When the actualities are considered, the Legislature thereby set up an existing intelligible principle, or standard, namely, that the Territorial tax should at all times be identical with and amount to one-tenth of the federal income tax. The Legislature was not acting in a vacuum. It must be deemed to have had knowledge of the more than thirty years of federal income tax history. A change in rate of the federal tax of as much as 10% would affect only 1% change in the Alaskan tax; the Alaskan Government is, after all, a component part of the National Government, and where events such as war might call for an extraordinary rise in federal tax rates, the expedience of a corresponding increase in the Alaskan rate might reasonably be anticipated, to remain in force until the Legislature next met. The fundamental bases of the federal income tax have long remained unchanged; the Legislature has observed its imposition and administration in Alaska year in and year out for many years and might reasonably anticipate that between its sessions Congress would make no fundamental alteration in the federal law. In the light

of this knowledge of the needs of Alaska and in view of the enormous advantages derived from territorial uniformity with the federal tax, the Legislature might reasonably have deemed it in the public welfare for the local income tax continually to be geared on the federal. This policy of uniformity was locally chosen by the Legislature in the exercise of its judgment; it was not imposed by the Federal Government. This identity might reasonably in its discretion seem more vital to the interests of the Territory than the fact that the later federal amendments between its sessions might bring into the Territorial law some details which the Legislature would not have originally approved of itself. Since the Legislature convenes biennially for a session of sixty days only (Organic Act, Section 6), the provision that the Alaskan law should follow the federal was requisite (R. 53), in implementing the policy of uniformity. Moreover, in case of necessity, the Governor possessed discretion to call an extraordinary session.

Congress, in amending the Internal Revenue Code, will not be legislating for Alaska or exercising a discretion conferred upon the Alaskan Legislature; on the contrary, the amendments to the Internal Revenue Code are external facts with reference to which the Legislature has set down a standard or principle. The Legislature has not abandoned any real control of the terms or rate of the tax. The rule established in the challenged statute is sufficiently precise and definite in practice and in view of all known realities, among others, of the federal income tax history and the retained power of correction. No legislature is continuously in session and the risk is always present that, as a practical matter, before it reconvenes the law for the time being may cease to reflect its will, as a result of intervening events or acts of others. Artificial con-

ceptualism aside, the future action of Congress upon the federal income tax between the Legislature's sessions is such an external event which the Legislature might here in the public interest reasonably risk.

Our contentions in connection with the instant statute are well summarized and supported by Sutherland in his classic text as follows (1 Statutes and Statutory Construction (3d ed., 1943), Sec. 310, pp. 68-70):

> The adoption of the statutes of another state or of Congress is frequently attacked as being a delegation of legislative power. Such adoption, however, is almost universally sustained when the foreign law as then *existing* is adopted as the law of the adopting state. Where the local legislation is contingent upon the enactment of a statute of another state or of Congress, some courts have held the statutes invalid. And more have held the adoption of prospective legislation in other states and in Congress an unconstitutional delegation. But the better view favors the validity of the statute in all three circumstances. Even in the third situation where another legislature may change not only the operation of local law but its substantive content, the statute should be sustained for its enactment has not amounted to any permanent loss of sovereignty or legislative power. It is possible that for a period of time after the change in the "foreign statute" and before the local legislature convenes, the law of the jurisdiction may not reflect local legislative desires; but this is so even with regard to purely local enactments. The local legislature retains its power to change the statute if it is not satisfactory. The advantages gained by uniformity of law between the states and the advantage of uniformity with congressional legislation, to say nothing of protection against retaliatory legislation, outweighs the disadvantages which may temporarily arise from changes in foreign laws.
>
> Decisions holding that the prospective adoption of foreign legislation is an invalid delegation of

> power seem particularly artificial in many situations where, if the authority was delegated under proper standards to an administrative officer, he would in fact adopt legislation and administrative regulations of other states or of the federal government. Some legislation has been written with this concept in mind.

Again, in Gellhorn, Administrative Law—Cases and Comments (1940) 220-221, the following is said:

> When, * * * a statute is designed to absorb content from extra-state action, the superior-subordinate relationship is no longer present, since the extra-state agency is not subject to the control of the enacting legislature. For this reason, specificity of command should no longer be the measure of the statute's adequacy. Rather, emphasis should be placed upon the statute's containing a sufficiently precise statement of the source and character of the contemplated extra-state action, so that there may be a ready determination whether the action in fact taken is the type of action which the legislature intended to affect the operation of the original enactment. In other words, the inquiry should shift from the question, "Has the legislature *controlled* the act of the subordinate?" to the question, "Has the legislature furnished enough criteria so that the extrinsic legislation may be *identified* as the legislation to which the domestic policy is to conform?" * * *

Directly pertinent are views expressed in a recent article entitled "Cooperative Federalism" by Professor Samuel Mermin, 57 Yale L. J. 1, 18 (November, 1947):

> * * * a state or municipal legislature is familiar enough with the announced political policies of an incumbent federal administration, knows the standards and purposes which have been outlined in a particular piece of federal legislation (e.g the Federal Food, Drug and Cosmetic Act) and may also

> know the identity of the federal administrator, if already appointed. In the light of such knowledge, and of the needs of its own state or city, the legislature may reasonably deem it in the public welfare to adopt as *its* policy, a program of having the local requirements exactly *keep pace* with the federal requirements. This identity may well seem more important to the legislature than the fact that the federal regulations may now or later include some requirements which it would not itself have authorized originally. And such an identity of requirements would be a locally determined local policy, not a policy imposed by the federal government. There is, in this view, no need to talk of "standards" or "contingencies"; the focus of attention of the legislative will is not the detailed, substantive federal requirements (it has already determined that *in general* they comport with its own desires) but the desirability of local-federal uniformity in a particular field.

Referring to the quotations from Gellhorn and Sutherland set forth, *supra,* Professor Mermin concludes (p. 26):

> In short, a sizable body of precedent exists for the invocation of an "intergovernmental relations" exception to the usual delegation analysis. And even on the usual analysis, as already shown, intergovernmental delegations or adoptions are defensible. Already at least two prominent students have criticized the cases which underlie the comment that "it is generally held that the adoption by or under authority of a state statute of prospective Federal legislation, or Federal administrative rules thereafter to be passed, constitutes an unconstitutional delegation of legislative power." It is submitted that the rule should and will give way with the years.

There is no novelty in a territory or state enacting laws adopting or dependent upon federal provisions.

Among such fields have been prohibition, national industrial recovery, migratory birds, narcotics, pure food and drugs, grain standards, air rules. See Comments, 33 Mich. L. Rev. 597, 601-603 (1935); J. P. Clark, The Rise of a New Federalism (1938); *In re Lasswell,* 1 Cal. App. 2d 183, 36 P. 2d 678 (cited by the court below (R. 53)); *Commonwealth* v. *Alderman,* 275 Pa. 483, *supra.* When all is said, the Federal Government is not foreign to its Territory, and its statutes are there domestic. Judicial authority supporting the validity of similar legislation in the tax field is: *Underwood Typewriter Co.* v. *Chamberlain,* 94 Conn. 47, 108 Atl. 154, affirmed, 254 U. S. 113; *McKesson & Robbins, Inc.* v. *Walsh,* 130 Conn. 460, 464-467 35 A. 2d 865; *People* v. *Fire Association of Phila.,* 92 N. Y. 311, 315-324, 44 Amer. Rep. 380, affirmed, 119 U. S. 110; *People ex rel. Pratt* v. *Goldfogle,* 242 N. Y. 277, 291-292, 151 N. E. 452; *Commonwealth* v. *Warner Bros.,* 345 Pa. 270, 27 A. 2d 62.

The Legislature has not abandoned any of its essential powers. The Legislature and not Congress has declared the subject of taxation, fixed the rate and described the property to be taxed, and in so doing had the right to make these flexible, so that they would be adjustable to conditions thereafter arising rather than that it was compelled to adopt a new statute every time some minor change in the federal tax law was made or to forego the enormous public benefit in uniformity.

In summary then, as above stated, it is urged the only question to be passed upon here is the incorporation of *existing* federal law. Should, however, the Court not agree, it is our further contention the statute is equally valid so far as it incorporates by reference the Internal Revenue Code, as hereafter amended, which the Legislature might adopt as a local policy in the exer-

cise of its "unlimited power expressly given" to tax by the Organic Act. *Pacific Fisheries* v. *Alaska, supra,* 269 U. S. 269, 277.

C. *The challenged statute does not improperly delegate to administrative officers the legislative power of the Territory*

1. *The statute makes no improper delegation to the United States Commissioner of Internal Revenue*

The Income Tax Act further provides as follows (Appendix, *infra*):

> SECTION 3. DEFINITIONS.
>
> * * * * * * *
>
> B. REFERENCES TO INTERNAL REVENUE CODE.
>
> * * * * * * *
>
> (2) Whenever any portion of the Internal Revenue Code incorporated by reference as provided in Paragraph (1) of this subsection refers to rules and regulations promulgated by the United States Commissioner of Internal Revenue, or hereafter so promulgated, they shall be regarded as regulations promulgated by the Tax Commissioner under and in accord with the provisions of this Act, unless and until the Tax Commissioner promulgates specific regulations in lieu thereof conformable with this Act.

The contention that this provision constitutes an invalid delegation of Territorial Legislative power finds refutation *a fortiori* in the reasons set forth in the preceding subpoint B. The grounds which justify uniformity in statutory provisions for the federal and territorial income tax equally call for uniformity in administrative construction of the uniform statutes. Besides, the quoted Section 3 B (2) sets down no iron rule; in the event that a federal regulation should in

a special case appear unwise and inapplicable to local circumstances, the statute vests full discretion in the Territorial Tax Commissioner to reject the federal and promulgate in lieu thereof local regulations. The federal regulation does not necessarily and automatically become the local regulation. *Brock* v. *Superior Court,* 9 Cal. 2d 291, 71 P. 2d 209.

Ample support for such local adoption of existing and prospective federal administrative construction of a common statute is found in the leading case of *In re Lasswell, supra,* 1 Cal. App. 2d 183, 203, 36 P. 2d 678, 687, where it was further pointed out that such authority may on occasion properly be vested even in private bodies. Another persuasive precedent, indeed, as here, involving the relationship of a territorial legislature to federal administrative officers, is the decision of the Supreme Court of Puerto Rico in *Irizarry* v. *District Court, supra,* which cites with approval and quotes the *Lasswell* case. The problem raised there was adoption by the insular legislature of prospective regulations to be promulgated by the Federal Administrator under the Federal Emergency Price Control Act. The Puerto Rican court reasoned (p. 98):

> In also providing in effect that the Federal regulations to be promulgated by the Administrator under the Federal statute, shall also be insular regulations, the legislature has simply selected the Federal Administrator as the administrative official who shall have the power "to fill up the details" within the broad but valid standards laid down in the law itself. Once we concede that the standard set up in the statute is valid and that the power to fill up the details may be delegated to an administrative official, the mere fact that the Legislature chooses to vest this power in an appropriate Federal rather than insular official does not in itself invalidate the statute or regulations.

The Puerto Rican court was followed and its language, *supra,* quoted with approval by the Supreme Court of Michigan in *People* v. *Sell,* 310 Mich. 305, 17 N.W. 2d 193, likewise involving local adoption of regulations promulgated and to be promulgated by the Federal Price Administrator. (Pp. 305, 320-326.) The Michigan court also refers to *In re Lasswell, supra.*[4] Mermin, Cooperative Federalism, 57 Yale L. J., *supra,* pp. 4-16, citing many cases, accords with the position here taken.

Finally, there is no showing here whatsoever that any federal Regulations not in existence at the time of the approval of the Territorial statute are applicable to the rights of any taxpayer involved in this litigation. Moreover, there can be no valid objection to administrative rulings on the ground that they are "prospective", since one of the principal purposes in vesting the power of regulation in administrative officers is to enable them to fill in details in particular cases arising *after* passage of a statute.

2. *The statute makes no improper delegation to the Territorial Commissioner of Taxation*

Appellant further asserts that Section 7 D of the Income Tax Act invalidly delegates authority to the Territorial Tax Commissioner. (Br. 29-31.) This section, which is quoted in the footnote,[5] deals with over-

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[4] *Cleveland* v. *Piskura,* 145 Ohio S. 144, 60 N.E. 2d 919, seems incorrectly decided, and in any event is not in point since, as already noted, the Tax Commissioner is not here automatically required to accept the federal Regulations.

[5] Section 7. Returns and Payment of Tax.

* * * * *

D. Overpayment, Credit and Refund. The tax Commissioner is authorized to credit or refund all overpayments of taxes, all taxes erroneously or illegally assessed or collected, all penalties collected without authority, and all taxes that are found unjustly assessed or excessive in amount, or in any manner wrongfully collected. The Tax Commissioner shall

payments, credits and refunds. A reading of the statute establishes that appellant's contention is without merit and was properly overruled below for the reasons given by the District Court. (R. 59-60.) The statute lays down an intelligible principle or standard reasonably clear whereby administrative discretion must be governed. *Yakus* v. *United States,* 321 U. S. 414, 424-427; *Bowles* v. *Willingham,* 321 U. S. 503, 514-516; Jaffe, Delegation of Legislative Power, 47 Columbia L. Rev. 359 (1947).

D. *The challenged statute is not invalid for indefiniteness or uncertainty*

Appellant argues that the provisions for incorporation by reference of future amendments to the Internal Revenue Code and the Regulations promulgated by the Commissioner of Internal Revenue cause the Alaskan statute to be void for indefiniteness or uncertainty. (Br. 31-32.) Surely a taxing act is not invalid because its terms may in the future be modified. The Alaskan tax is no more invalid for this reason than is the federal income tax with which it is coordinated.

Again, here, appellant has not shown that any supposed indefiniteness or uncertainty in this or any other respect has been here applied against it or injured it or its employees, and accordingly, this hypothetical objection is not presented to the Court for decision.

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by means of rules and regulations specify the manner in which claims for credits or refunds shall be made, including adjustments with persons whose sole income in Alaska consists of wages or salary, prescribed limitations and give notice of allowance or disallowance. These rules and regulations shall be based upon the provisions of Secs. 321 and 322 of the Internal Revenue Code insofar as such provisions are consistent with other provisions of this Act. When refund is allowed to a taxpayer, same shall be paid out of the general fund on a Territorial warrant issued pursuant to a voucher approved by the Tax Commissioner.

E. *The challenged statute does not violate the uniformity clause of the Organic Act*

Appellant flatly argues that "the legislature had no authority to enact a graduated net income tax law" at all. (Br. 22.) It is asserted that a graduated income tax infringes the provision of the Organic Act that "all taxes shall be uniform upon the same class of subjects". (Section 9, Appendix, *infra.*) However, like the analogous constitutional provision, the cited clause of the Organic Act requires only geographical uniformity, not intrinsic uniformity. The holding of the Court of Appeals for the First Circuit in *Ballester-Ripoll* v. *Court of Tax Appeals of P. R.,* 142 F. 2d 11, certiorari denied, 323 U. S. 723, citing the relevant Supreme Court decisions and sustaining the Puerto Rican income tax as against a similar objection based on the uniformity clause contained in the Organic Act of Puerto Rico, is completely in point (p. 18):

> The taxpayer also contends that the progressive rates embodied in the Act are in conflict with the requirement of § 2 of the Organic Act that "the rule of taxation in Porto Rico shall be uniform." It is settled that the analogous, constitutional provision that "all Duties, Imposts [or] Excises shall be uniform throughout the United States" (art 1, § 8) requires only geographical uniformity. *Knowlton* v. *Moore,* 1900, 178 U. S. 41, 20 S. Ct. 747, 44 L. Ed. 969. Although it is true that the decision therein was based in part on the words "throughout the United States" which do not appear in the similar provision in the Organic Act, that was merely one ground for the decision. The Supreme Court said, page 92 of 178 U. S., page 767 of 20 S. Ct., 44 L. Ed. 969:
>
> "But one of the most satisfactory answers to the argument that the uniformity required by the Constitution is the same as the equal and uniform clauses which has since been embodied in so many

of the state constitutions, results from a review of the practice under the Constitution from the beginning. From the very first Congress down to the present date, in laying duties, imposts, and excises the rule of inherent uniformity, or, in other words, intrinsically equal and uniform taxes, has been disregarded, and the principle of geographical uniformity consistently enforced."

When Congress came to enact the section entitled "Bill of Rights" of the Organic Act of Puerto Rico, as in the similar section of the Philippine Organic Act, it incorporated the Bill of Rights of our Constitution with little alteration. It is reasonable to suppose that when Congress carried over the requirement of uniformity in taxation from the Constitution into the Organic Act of Puerto Rico, it intended the same meaning for the term that it had always attributed to it in the passing of legislation for continental United States and that had been applied in the courts.

As the Supreme Court said in discussing another provision in the corresponding Bill of Rights for the Philippine Islands:

"How can it be successfully maintained that these expressions of fundamental rights, which have been the subject of frequent adjudications in the courts of this country, and the maintenance of which has been ever deemed essential to our government, could be used by Congress in any other sense than that which has been placed upon them in construing the instrument upon which they were taken?

"It is a well-settled rule of construction that language used in a statute which has a settled and well-known meaning, sanctioned by judicial decision, is presumed to be used in that sense by the legislative body." *Kepner* v. *United States*, 1904, 195 U. S. 100, 124, 24 S. Ct. 797, 802, 49 L. Ed. 114, 1 Ann. Cas. 655.

The guarantees which Congress has extended to Puerto Rico are to be interpreted as meaning what like provisions meant at the time when Congress made them applicable to Puerto Rico. * * *

This holding and particularly the quoted ruling from *Knowlton* v. *Moore,* 178 U. S. 41, 92, refutes appellant's argument that the uniformity clause is the same as the equal and uniform clauses found in some state constitutions. The uniformity provision is violated only where the Legislature discriminates in favor of or against persons in a particular section of the Territory. This principle was again applied in *South Porto Rico Sugar Co.* v. *Buscaglia,* 154 F. 2d 96, 100 (C. A. 1st), where many authorities are cited, and reiterated in *Rullan* v. *Buscaglia,* 168 F. 2d 401, 403 (C. A. 1st), certiorari denied, 335 U. S. 857. Surely, a construction which would deny to Alaska the power to impose a progressive income tax, that is, to levy an income tax with reference to ability to pay, is to be avoided, particularly in view of the full power of taxation which, as has been seen in subpoint A, *supra,* is vested in the Legislature, according to the highest authority. There is no reason to suppose that Congress intended to grant less power in this respect to the Legislature of Alaska than to the legislatures of the sister Territories of Hawaii and Puerto Rico, where graduated income taxes have long been levied.[6]

F. *The criticized classifications made by the statute were well within the area of legislative discretion, and were not arbitrary nor in denial of due process*

Classifications provided in the Income Tax Act can be held violative of the Constitution only "when palpably arbitrary". *Kitagawa* v. *Shipman, supra,* p. 318. What the First Circuit Court of Appeals, sustaining a local taxing statute, said in *South Porto Rico Sugar Co.* v. *Buscaglia, supra,* with respect to the discretion vested

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[6] Revised Laws of Hawaii (1945), c. 102.

in the Legislature of Puerto Rico, is equally applicable to the Legislature of Alaska, as follows (p. 100):

> The area of permissible legislation for state legislatures is extremely broad. *Wisconsin* v. *J. C. Penney Co.,* 311 U. S. 435, 444, * * *. The discretion of the Legislature of Puerto Rico as far as local matters are concerned is not a great deal narrower. *Puerto Rico* v. *Shell Co.,* 302 U. S. 253, 261-262. * * * Moreover, the burden is on the one who attacks as invalid a legislative enactment to negative every conceivable basis which might support it. *Madden* v. *Kentucky,* 309 U. S. 83, 88; * * * *Metropolitan Casualty Ins. Co. of New York* v. *Brownell,* 294 U. S. 580, 584, * * *.

Indeed, this is also the essential principle which the Supreme Court applied in testing an Alaskan taxing act, in *Alaska Fish Co.* v. *Smith, supra,* saying (p. 49):

> The requirement of uniformity in § 9 is disposed of by what we have said of the classification when considered with reference to the Constitution.

Similarly, in *Pacific Fisheries* v. *Alaska, supra,* a local taxing act was sustained against attack for alleged denial of due process of law, since (p. 278):

> The inequalities of the tax are based upon intelligible grounds of policy and cannot be said to deny the petitioner its constitutional rights.

In *Madden* v. *Kentucky,* 309 U. S. 83, 88, in language much quoted which is here pertinent, the Supreme Court said:

> Since the members of a legislature necessarily enjoy a familiarity with local conditions which this Court cannot have, the presumption of constitutionality can be overcome only by the most explicit demonstration that a classification is a hostile and oppressive discrimination against particular persons and classes.

Again, in *Lawrence* v. *State Tax Comm.,* 286 U. S. 276, the Supreme Court said (p. 284):

> The equal protection clause does not require the state to maintain a rigid rule of equal taxation, to resort to close distinctions, or to maintain a precise scientific uniformity; and possible differences in tax burdens not shown to be substantial or which are based on discriminations not shown to be arbitrary or capricious, do not fall within constitutional prohibitions.

The Fourteenth Amendment clearly has no application to the Territory.[7] *South Porto Rico Sugar Co.* v. *Buscaglia, supra,* p. 101; *Anderson* v. *Scholes,* 83 F. Supp. 681, 687 (Alaska, 3d). In last analysis, the tax must be tested by the due process clause of the Fifth Amendment, with respect to which it was said in the *South Porto Rico Sugar Co.* case, *supra,* p. 100:

> "To be unconstitutional under the due process clause a taxing statute must be so arbitrary as to amount to a confiscation or a clear and gross inequality or injustice." Mertens, Law of Federal Taxation, Vol. 1, § 4.09. The effect of this standard has been that the due process clause of the Fifth Amendment has not often been used as a means of declaring invalid a federal tax statute. See Mr. Justice Stone dissenting in *Heiner* v. *Donnan,* 285 U. S. 312, 338, 52 S. Ct. 358, 76 L. Ed. 772.

Examining appellant's principal criticisms of the statute in this light, it seems evident that appellant has not established that the statute is palpably arbitrary

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[7] The Civil Rights Act, Revised Statutes, Section 1977 (8 U.S.C. 1946 ed., Sec. 41), quoted by appellant (Br. 19-20), which guarantees to all persons in the Territory the equal benefit of all laws for security of persons and property as is enjoyed by *white* citizens, on its face has no application to the instant issue, as indeed its well known history alone must confirm. Further, even if applicable, it would add nothing to the rule that sustains a classification not palpably arbitrary or capricious.

and certainly has not sustained the heavy burden of negativing every conceivable basis which might support it.

(a) The Legislature in its discretion might recognize the existence of and deem it advisable to afford taxpayers the benefit in computing income for 1949 of operating losses which had been incurred in preceding years, and accordingly was not, contrary to appellant's contention (Br. 23-24), palpably arbitrary in adopting by reference the net operating loss carryover provisions contained in Section 122 of the Internal Revenue Code (26 U. S. C. 1946 Ed., Sec. 122). In determining what income should be taxed in the first year of the law, as well as in any subsequent year, the Legislature might, within the area of legislative discretion properly recognize the effect of transactions during the preceding years upon certain taxpayers' incomes.

(b) The same answer is true with respect to the application of the unused capital loss carryover provided for by Section 117 (e) of the Internal Revenue Code 26 U. S. C. 1946 Ed., Sec. 117). (Br. 24.)

(c) Similarly, it is not established that the classifications with respect to appointment of salary and other income earned in Alaska by nonresidents is so palpably arbitrary as to violate fundamental law and that no basis may be conceived which might support it. (Br. 24-28.) [8] No iron rule of apportionment is laid down but the Tax Commissioner is expressly empowered upon a taxpayer's petition to grant relief in cases of hardship where the general formulae apply unfairly (Section 5 A (2)(c)), and the Tax Commissioner's ruling on such a petition is subject to court review (Section 13). Appellant's employees were

[8] Similar contentions are made in the brief filed on behalf of *Alaska Packers Association* as *amicus curiae,* pp. 3-14.

either residents of Alaska, with respect to whom no question of apportionment is involved, or seamen, in whose case an apportionment formula is expressly provided. (Section 5 B (1), Appendix, *infra.*) Hence, the alleged omission of an apportionment formula for other nonresident wage earners is not before the Court. It may well be that when such a case does arise, the statute will be construed to include only the wages or salary of such nonresidents earned in Alaska. Section 5 B. The seamen, who are the only nonresidents involved in this case, are taxed only in proportion to pay earned in Alaska waters. Certainly, there is nothing inherently arbitrary in this method of apportionment. *Shaffer* v. *Carter,* 252 U. S. 37; *Travis* v. *Yale & Towne Mfg. Co.,* 252 U. S. 60.

Nor is there anything in this record to show that the criticized method of apportionment with respect to operations of other persons, such as foreign corporations doing business in the Territory, is inherently arbitrary. *Underwood Typewriter Co.* v. *Chamberlain,* 254 U. S. 113, 121; and authorities there listed in fn. 1 on p. 121; Silverstein, Problems of Apportionment in Taxation of Multistate Business, 4 Tax L. Rev. 207 (January, 1949).

In any event, it is a complete answer that these questions with respect to apportionment formulae, which appellant and the *amicus* party, Alaska Packers Association, seek to raise, are, on well settled principles, not before this Court for decision at all. Only those to whom a statute applies and who are adversely affected can draw into question its validity on constitutional grounds. (See authorities cited in subpoint B (1) of this brief, *supra.*) Thus, Mr. Justice Holmes, speaking for the Supreme Court, held in *Hatch* v. *Reardon,* 204 U. S. 152, 160-161:

> But there is a point beyond which this court does not consider arguments of this sort for the purpose of invalidating the tax laws of a State on constitutional grounds. This limit has been fixed in many cases. It is that unless the party setting up the unconstitutionality of the state law belongs to the class for whose sake the constitutional protection is given, or the class primarily protected, this court does not listen to his objections, and will not go into imaginary cases, notwithstanding the seeming logic of the position that it must do so, because if for any reason, or as against any class embraced, the law is unconstitutional, it is void as to all. *Supervisors* v. *Stanley,* 105 U. S. 305, 311; *Clark* v. *Kansas City,* 176 U. S. 114, 118; *Lampasas* v. *Bell,* 180 U. S. 276, 283, 284; *Cronin* v. *Adams,* 192 U. S. 108, 114. If the law is valid when confined to the class of the party before the court, it may be more or less of a speculation to inquire what exceptions the state court may read into general words, or how far it may sustain an act that partially fails. With regard to taxes, especially, perhaps it might be assumed that the legislature meant them to be valid to whatever extent they could be sustained, or some other peculiar principle might be applied. See *e. g. People's National Bank* v. *Marye,* 191 U. S. 272, 283.

How the statute may be applied under other sets of facts, especially in view of the broad discretion afforded to the Tax Commissioner above referred to (Section 5 A (2)(c)), is a matter of sheer speculation, and not presented here for decision in any sense. *Plymouth Coal Co.* v. *Pennsylvania,* 232 U. S. 531, 534; *Federation of Labor* v. *McAdory,* 325 U. S. 450, 463.

G. *Provision for suspension of licenses to do business as a penalty for nonpayment of the income tax was not unconstitutional*

Section 12 C of the Income Tax Act authorizes the suspension of a license to conduct any business issued

by Alaska to any taxpayer, whether a resident or not, should he fail to pay the tax. The suspension is to be imposed until the tax is paid in full. No license belonging to appellant has been suspended or threatened to be suspended here, and again this question which appellant raises (Br. 28-29), claiming infringement of the Commerce Clause of the Federal Constitution (Article I, Section 8) is hypothetical and not here for decision. As the court below well noted, Section 12 C in any event is not reasonably susceptible of a construction that payment of the tax is a condition precedent to the right to carry on business in the Territory in the first instance. Certainly, forfeiture of any territorial license may be imposed as a sanction to assist in collection of past due territorial taxes. (R. 55-56.)

H. *Ratification in the instant Act of the withholdings made under the repealed Chapter 3 of the Session Laws (1949) was within the legislative power*

Section 16 of the Income Tax Act (Appendix, *infra*) repealed the earlier Income Tax Act passed by the Extraordinary Session on January 22, 1949 (Chapter 3 of the Session Laws of Alaska (1949)), but ratified and confirmed tax withholdings which had been effectuated thereunder. Appellant asserts this ratification was ineffective. (Br. 34-35.) The court below, as already noted in the Statement of Facts, *supra,* held that the Legislature in the Extraordinary Session had not been legally constituted, but that the Regular Session which passed the instant statute validly ratified or confirmed tax withholdings theretofore made. (R. 46-51, 66-67.) The sustained objections to the January statute were merely to the composition of the session passing it; not to any asserted lack of power in the Legislature, when properly constituted, to impose an

income tax and prescribed withholdings. The instant statute, while repealing the earlier law, imposed the tax retroactively for the same period as was covered by the earlier law, namely, to taxable years beginning January 1, 1949. It is, of course, settled that an income tax may be imposed retroactively, for which, indeed, there is ample congressional precedent. *Welch* v. *Henry,* 305 U. S. 134; *Wilgard Realty Co.* v. *Commissioner,* 127 F. 2d 514 (C.A. 2d), certiorari denied, 317 U. S. 655. The taxes withheld were, thus, due under the terms of the valid instant statute and no adequate reason appears why the Legislature could not, in the exercise of its discretion, ratify and confirm their prior withholding. See, also, authorities cited in the opinion below. (R. 60.)

I. *The withholding provisions on seamen's wages are not in conflict with federal statutes*

As already stated, the taxpayer employees of appellant were both resident Alaskans who were agents, assistant agents and shore employees (R. 64), and seamen, who were nonresidents of the Territory. Approximately 75% of the time spent on voyages in the corporation's vessels are in territorial waters and in waters off shore from the coast of Alaska; part of the voyages are made through Canadian waters and part outside the three mile limit off the Alaskan coast. (R. 62-63.)

In the case of employees generally (Sections 5 B and 8 A and B, Appendix, *infra*), the tax levied is 10% of the federal income tax collected by salary deduction and withholding by employers under the Internal Revenue Code, Sections 1621 to 1627, being subchapter D of Chapter 9 (26 U.S.C. 1946 ed., Secs. 1621-1627). This general rule, however, is further particularly

limited in the case of seamen by the following provision (Section 5 B (1)):

> (1) The tax levied by this subsection shall apply to that portion of the voyage pay of vessel personnel of interstate carriers engaged in the Alaska trade which is earned in the waters of Alaska, * * *.

Thus, it is to be noted that the tax is not imposed on seamen engaged in foreign trade but only on the personnel of coastwise or interstate carriers, and limited to the portion of the pay earned in Alaska. For purposes of the federal income tax the wages of seamen so engaged are regarded as from sources within the United States,[9] and are further *subject to withholding* deductions.[10] If such services are performed partly

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[9] Treasury Regulations 111, relating to the Income Tax under the Internal Revenue Code, Section 29.119-4, provide:

> SEC. 29.119-4. *Compensation for Labor or Personal Services.* —* * * wages received for services rendered inside the territorial limits of the United States and wages of an alien seaman earned on a coastwise vessel are to be regarded as from sources within the United States. * * *

Alaska is, of course, for the purposes of the Internal Revenue Code, included within the term "United States". 8 Mertens, Law of Federal Income Taxation, Sec. 45.33, p. 308; Internal Revenue Code, Sec. 3797 (a) (9) (26 U.S.C. 1946 ed., Sec. 3797).

[10] Treasury Regulations 116, relating to the collection of income tax at source on wages under the Internal Revenue Code, Section 405.102 (h) (as amended by T. D. 5645, 1948-2 Cum. Bull. 14, 25), provide:

> SEC. 405.102. *Exclusions from Wages.*— * * *
>
> * * * * *
>
> (h) *Remuneration for services performed outside the United States.*— * * *
>
> For the purposes of this subsection, services performed on or in connection with (1) an American vessel under a contract of service which is entered into within the United States or during the performance of which the vessel touches at a port in the United States or (2) any vessel as an employee of the United States employed through the War Shipping Administration are not considered as services performed outside the United States. Hence, the remuneration paid for such services constitutes wages subject to withholding within the meaning of section 1621 (a) and these regulations unless the employee performing such services is a nonresident alien.

within and partly without the United States, the apportionment formula for federal taxation is on a time basis,[11] and thus closely resembles the provision of the Alaskan statute.

Appellant asserts that the withholding provisions of the Territorial Act are invalid so far as applicable to its seamen employees for conflict with other federal statutes (Br. 11-14), citing *American Hawaiian S. S. Co.* v. *Fisher,* 82 F. Supp. 193 (D. Ore.). The principal federal statute claimed to be infringed is the Act of March 4, 1915, c. 153, 38 Stat. 1164, Sec. 12 (46 U.S.C. 1946 ed., Sec. 601) quoted, so far as pertinent, in the footnote.[12] The lower court correctly overruled this contention and held there is no conflict between the territorial statute and this federal legislation. (R. 58-59.) The familiar withholding device, common to many taxing statutes, is certainly not accurately characterized by nor does it fall within the meaning of an "attachment or arrestment from any court". Con-

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[11] Thus, Treasury Regulations 111, *supra,* Section 29.119-4, reads in this connection:

> If no accurate allocation or segregation of compensation for labor or personal services performed in the United States can be made, or when labor or service is performed partly within and partly without the United States, the amount to be included in the gross income shall be determined by an apportionment on the time basis, i.e., there shall be included in the gross income an amount which bears the same relation to the total compensation as the number of days of performance of the labor or services within the United States bears to the total number of days of performance of labor or services for which the payment is made. * * *

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[12] Sec. 12. That no wages due or accruing to any seaman or apprentice shall be subject to attachment or arrestment from any court, and every payment of wages to a seaman or apprentice shall be valid in law, notwithstanding any previous sale or assignment of wages or of any attachment, encumbrance, or arrestment thereon; and no assignment or sale of wages or of salvage made prior to the accruing thereof shall bind the party making the same, except such allotments as are authorized by this title. * * *

gress and the Treasury obviously did not understand by the Internal Revenue Code amendments provided in the Current Tax Payment Act of 1943, c. 120, 57 Stat. 126, and the Treasury Regulations, *supra,* promulgated thereunder, that collection through withholdings from the salaries of seamen, such as those here involved, was in conflict with or to any extent repealed the earlier statutes upon which appellant relies.

J. *In any event, the Legislature intended the valid provisions of the statute to be severable, and remain in force and effect, should the criticized provisions be held invalid*

Section 15 of the Act (Appendix, *infra*), provides:

> Section 15. SEVERABILITY. If any provision of this Act, or the application thereof to any person or circumstance is held invalid, the remainder of the Act and such application to other persons or circumstances shall not be affected thereby.

Contrary to appellant's contention (Br. 32-34), especially in view of the quoted Section 15, it appears clear that the Legislature would have enacted the balance of the statute and intended it to possess full force and effect, even if the parts criticized by appellant were deemed invalid. For example, it is not reasonable to suppose that the Legislature would have vitiated the entire income tax for 1949 and thus seriously imperiled the current support of the Territorial government, in the event it should have learned that for later years the Alaskan Act could not properly be continuously maintained uniform with the Internal Revenue Code.

The holding of the Court of Appeals for the First Circuit, and the authorities cited therein, in *San Juan Trading Co.* v. *Sancho,* 114 F. 2d 969, certiorari denied, 312 U. S. 702, construing a similar severability provi-

sion in a Puerto Rican statute, state the settled rule (p. 975):

> Section 108 of the Internal Revenue Law of Puerto Rico has the usual provision that if any provision of the Act or its application to any person or circumstances be declared invalid, the remainder of the Act and the application of those provisions to other persons or circumstances should not be affected. Such a legislative declaration indicates that if any of the provisions are found invalid, the Legislature would have passed the Act without such provisions and desires the Act to be considered as not containing them. *Williams* v. *Standard Oil Co.,* 1929, 278 U. S. 235, 49 S. Ct. 115, 73 L. Ed. 287, 60 A.L.R. 596. It is elementary that where part of a statute is invalid that which is unobjectionable will stand if the Legislature did not intend the good and bad portions to stand or fall together. *Bowman* v. *Continental Oil Co.,* 1921, 256 U. S. 642, 41 S. Ct. 606, 65 L. Ed. 1139; *Loeb* v. *Columbia Township Trustees,* 1900, 179 U. S. 472, 489, 21 S. Ct. 174, 45 L. Ed. 280.

Had the Legislature foreseen any such alleged invalidity it would have intended the balance of the statute to remain in effect. *Ballester-Ripoll* v. *Court of Tax Appeals of P. R., supra,* p. 19.

Finally, as already discussed and on authorities cited in subpoint B (1) *supra,* appellant has no standing here to raise an alleged issue of severability for it cannot show that it has been injured by any purportedly invalid part and complaints on grounds of nonseverability may be considered only after a person injured by the alleged invalid portion has requested relief.

CONCLUSION

The judgment of the District Court should in all respects be affirmed.

Respectfully submitted,

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NOVEMBER, 1949.

APPENDIX

Constitution of the United States of America:

ARTICLE IV

* * * * *

Section 3. * * *

The Congress shall have Power to dispose of and make all needful Rules and Regulations respecting the Territory or other Property belonging to the United States; * * *

AMENDMENT XIV

Section 1. All persons born or naturalized in the United States, and subject to the jurisdiction thereof, are citizens of the United States and of the State wherein they reside. No State shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States; nor shall any State deprive any person of life, liberty, or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws.

Organic Act of Alaska (Act of August 24, 1912), c. 387, 37 Stat. 512:

SEC. 3. CONSTITUTION AND LAWS OF UNITED STATES EXTENDED.—That the Constitution of the United States, and all the laws thereof which are not locally inapplicable, shall have the same force and effect within the said Territory as elsewhere in the United States; * * * that except as herein provided all laws now in force in Alaska shall continue in full force and effect until altered, amended, or repealed by Congress or by the legislature: *Provided,* That the authority herein granted to the legislature to alter, amend, modify, and repeal laws in force in Alaska shall not extend to the customs, internal-revenue, postal, or other general laws of the United States or to the game, fish, and fur-seal laws and laws relating to fur-bearing animals

of the United States applicable to Alaska, or to the laws of the United States providing for taxes on business and trade, or to the Act entitled "An Act to provide for the construction and maintenance of roads, the establishment and maintenance of schools, and the care and support of insane persons in the District of Alaska, and for other purposes," approved January twenty-seventh, nineteen hundred and five, and the several Acts amendatory thereof: *Provided further,* That this provision shall not operate to prevent the legislature from imposing other and additional taxes or licenses. * * *

(48 U.S.C. 1946 ed., Secs. 23 and 24.)

SEC. 4 [as amended by the Act of November 13, 1942, c. 637, 56 Stat. 1016]. THE LEGISLATURE.—That the legislative power and authority of said Territory shall be vested in a legislature, * * *.

(48 U.S.C. 1946 ed., Sec. 67.)

SEC. 9 [as amended by the Act of June 3, 1948, c. 396, 62 Stat. 302]. LEGISLATIVE POWER—LIMITATIONS.—The legislative power of the Territory shall extend to all rightful subjects of legislation not inconsistent with the Constitution and laws of the United States, * * * Provided, That all authorized indebtedness shall be paid in the order of its creation; all taxes shall be uniform upon the same class of subjects and shall be levied and collected under general laws, and the assessments shall be according to the actual value thereof. * * *

(48 U.S.C. 1946 ed., Secs. 77 and 78.)

SEC. 20. LAWS SHALL BE SUBMITTED TO CONGRESS.—That all laws passed by the Legislature of the Territory of Alaska shall be submitted to the Congress by the President of the United States, and, if disapproved by Congress, they shall be null and of no effect.

(48 U.S.C. 1946 ed., Sec. 90.)

Session Laws of Alaska (1949), c. 115, approved March 26, 1949 (Alaska Net Income Tax Act):

Section 3. Definitions.

A. In General: For the purpose of this Act—

* * * * *

(8) The words "Internal Revenue Code" mean the Internal Revenue Code of the United States (53 Stat. 1) as amended or as hereafter amended.

* * * * *

B. References to Internal Revenue Code.

(1) Whenever the Internal Revenue Code is mentioned in this Act, the particular portions or provisions thereof, as now in effect or hereafter amended, which are referred to, shall be regarded as incorporated in this Act by such reference and shall have effect as though fully set forth herein.

(2) Whenever any portion of the Internal Revenue Code incorporated by reference as provided in Paragraph (1) of this subsection refers to rules and regulations promulgated by the United States Commissioner of Internal Revenue, or hereafter so promulgated, they shall be regarded as regulations promulgated by the Tax Commissioner under and in accord with the provisions of this Act, unless and until the Tax Commissioner promulgates specific regulations in lieu thereof conformable with this Act.

* * * * *

Section 5. Tax on Individuals, Fiduciaries, Corporations and Banks.

A. General Rule. There is hereby levied and there shall be collected and paid for each taxable year upon the net income of every individual (except employees whose sole income in Alaska consists of wages or salary upon which tax has been withheld as referred to in subsection B of this Section), fiduciary, corporation and bank, required

to make a return and pay a tax under the Federal income tax law, a tax computed by either one of the following methods:

(1) a tax equal to 10 percent of the total income tax that would be payable for the same taxable year to the United States under the provisions of the Internal Revenue Code without the benefit of the deduction of the tax payable hereunder to the Territory.

(2) a tax equal to 10 percent of that portion of the total income tax that would be payable under the provisions of the Internal Revenue Code without the benefit of the deduction of tax payable hereunder to the Territory, that gross receipts derived from sources within the Territory, payroll and value of tangible property located in the Territory, bears to the total gross receipts from sources within and without the Territory, payroll and value of tangible property within and without the Territory.

(a) Determination of Gross Receipts. Gross receipts from sources within the Territory shall consist of interest, rents, royalties, gains, dividends, all other income and gross income received or derived in connection with property owned or a business or trade carried on and salaries, wages and fees for personal services performed within the Territory. Income received or derived from sales wherever made of goods, wares and merchandise manufactured or originating in the Territory shall be considered to be a part of gross receipts from sources within the Territory.

* * * * *

B. Employees. There is hereby levied upon and there shall be collected from every employee including persons referred to in subsection (C) of Section 1621 of the Internal Revenue Code) whose sole income in Alaska during the taxable year consists of wages or salary, a tax in the amount of ten

percent of the tax deducted and withheld under the provisions of sub-chapter (D), Chapter 9, of the Internal Revenue Code, which tax is to be withheld by the employer under the provisions of Section 8 of this Act. * * *

(1) The tax levied by this subsection shall apply to that portion of the voyage pay of vessel personnel of interstate carriers engaged in the Alaska trade which is earned in the waters of Alaska, including the waters over the continental shelf. The tax shall likewise apply to that portion of the pay earned in Alaska of the personnel of carriers operating vehicles or airplanes on land or in the air on routes to and from Alaska.

* * * * *

Section 7. Returns and Payment of Tax.

A. Tax Returns. Every individual (except an employee whose sole income in Alaska during the taxable year consists of wages or salary upon which tax has been withheld), fiduciary, partnership, corporation and bank required to make a return under the provisions of the Internal Revenue Code, shall at the same time render to the Tax Commissioner a return setting forth: (1) the amount of tax and the balance of tax due or overpayment of tax as reported on returns made to the Collector of Internal Revenue; (2) the amount of tax due under this Act, less credits claimed against tax; (3) such other information for the purpose of carrying out the provisions of this Act as may be prescribed by the Tax Commissioner. The return shall either be on oath or contain a written declaration that it is made under the penalty of perjury, and the Tax Commissioner shall prescribe forms accordingly. The provisions of Sections 51, 52 and 53 of the Internal Revenue Code shall be adopted insofar as such provisions are consistent with other provisions of this Act.

B. Payment of Tax. The total amount of tax imposed by this Act shall be due and payable to the

Tax Commissioner at the same time and in the same manner as the tax payable to the United States Collector of Internal Revenue under the provisions of Section 56 of the Internal Revenue Code.

C. Federal Income Tax Return. Any taxpayer, upon request by the Tax Commissioner, must furnish to the Tax Commissioner a true and correct copy of any tax return which he has filed with the United States Collector of Internal Revenue. Every taxpayer must notify the Tax Commissioner in writing of any alteration in, or modification of, his Federal income tax return and of any recomputation of tax or determination of deficiency (whether with or without assessment). A full statement of the facts shall accompany this notice, which must be filed within twenty days after such modification, recomputation or determination of deficiency, and the taxpayer must pay the additional tax or penalty hereunder.

* * * * *

Section 8. Collection of Income Tax at Source.

A. Definitions. As used in this Section, with the exception of Federal government employees, the terms "wages", "payroll period", "employee", and "employer" shall have the meaning attributed to such terms by subsections (a), (b), (c), and (d), respectively, of Section 1621 of the Internal Revenue Code.

B. Requirement of Withholding. Every employer making payment of wages or salaries shall deduct and withhold a tax in the amount of 10 per cent of the tax deducted and withheld under the provisions of subchapter (D), Chapter 9 of the Internal Revenue Code. Every employer making a deduction and withholding as outlined above, shall furnish to the employee upon request a record of the amount of tax withheld from such employee on forms to be prescribed, prepared and furnished by the Tax Commissioner.

* * * * *

Section 14. Administrative Powers.

A. Tax Commissioner to Administer. The Tax Commissioner is hereby required to administer the provisions of this Act.

* * * * *

C. Rules and Regulations. The Tax Commissioner shall prescribe and furnish all necessary forms, and promulgate and publish all needful rules and regulations in plain and concise language conformable herewith for the assessment and collection of any tax herein imposed. He shall apply as far as practicable the administrative and judicial interpretations of the Federal income tax law. The Tax Commissioner shall also prepare a concise statement of the contents of the Code sections referred to herein for the information of the taxpayer and make the same available to the taxpayer making a return.

* * * * *

Section 15. Severability. If any provision of this Act, or the application thereof to any person or circumstance is held invalid, the remainder of the Act and such application to other persons or circumstances shall not be affected thereby.

Section 16. Repeals. The tax contained in subsection 3rd of Sec. 35-1-11 ACLA 1949, which reads as follows: "three-quarters of one percent of the net profits from supplies sold" is hereby repealed; and the unnumbered paragraph between subsections (f) and (g) of subsection 7th of Sec. 35-1-11 ACLA 1949, which imposes a net income tax on canneries, is hereby repealed; and the tax contained in House Bill No. 1 of the Extraordinary Session of the Nineteenth Legislature, which will become Ch. 3 of the Session Laws of said session, is also hereby repealed, but tax withholdings effectuated and other administrative steps taken thereunder are hereby ratified and confirmed and made applicable hereunder so far as conformable with the provisions hereof.

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No. 12298

IN THE UNITED STATES

COURT OF APPEALS

FOR THE NINTH CIRCUIT

ALASKA STEAMSHIP COMPANY, a Corporation,

Appellant,

v.

M. P. MULLANEY, Commissioner of Taxation, Territory of Alaska,

Appellee.

REPLY BRIEF FOR THE APPELLANT

Upon Appeal from the District Court for the Territory of Alaska, First Division

BOGLE, BOGLE & GATES
FRANK L. MECHEM,
Central Building,
Seattle, Washington.

FAULKNER, BANFIELD & BOOCHEVER
H. L. FAULKNER,
Juneau, Alaska

For Appellant

FARWEST LITHOGRAPH & PRINTING COMPANY, SEATTLE

IN THE UNITED STATES

COURT OF APPEALS

FOR THE NINTH CIRCUIT

ALASKA STEAMSHIP COMPANY, a Corporation,

Appellant,

v.

M. P. MULLANEY, Commissioner of Taxation, Territory of Alaska,

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Juneau, Alaska

For Appellant

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IN THE UNITED STATES

COURT OF APPEALS

FOR THE NINTH CIRCUIT

ALASKA STEAMSHIP COMPANY, a Corporation,
Appellant,

v.

M. P. MULLANEY, Commissioner of Taxation, Territory of Alaska,
Appellee.

REPLY BRIEF FOR THE APPELLANT

This brief has been prepared principally as a reply to the brief for the United States as *amicus curiae,* and for convenience of reference, the arguments advanced by *amicus curiae* will be discussed under the appropriate headings of that brief, with specific reference to appellee's brief wherever necessary.

PRELIMINARY CONSIDERATIONS

In describing the interest of the United States in this controversy, and elsewhere throughout the brief, *amicus curiae* has referred to the alleged undesirable effect upon the Territory of Alaska if the Alaska Net Income Tax Act should be held invalid. Generalizations are offered to the effect that maintenance of law and order, public health, etc., would suffer seriously and adversely and that it might become necessary to call upon Congress for assistance in these respects.

For the purpose of clarifying the atmosphere in which this controversy exists the attention of this Court is invited to the fact that the record in this case contains not a single word of testimony or evidence even remotely bearing upon

these matters and, accordingly, they could properly come before this Court only upon the ground that judicial notice may properly be taken of them.

We do not think that these are appropriate matters for judicial notice, but if they are then the actual facts may be summarized as follows:

1. According to a special report of the Territorial Senate Finance Committee, which was never published in the Senate Journal, the Alaska Net Income Tax was budgeted to produce, at the very outside, not to exceed 15% of the cost of operating the Territorial government for the biennium ending April 1, 1951.

2. The total Territorial appropriations for Alaska by Congress for the current fiscal year are $218,519,000, plus an additional contract authority of nearly $30,000,000.[1] If this fiscal year appropriation were translated into a biennium to conform with the appropriations of the Territorial legislature then only 5% of the cost of operating the Territorial government is borne by the Territory and only 15% of that 5% would be derived from the challenged income tax law.

3. With respect to law and order there are four principal agencies in the Territory charged with the duty of enforcing the laws and maintaining order. These are United States Marshals and their deputies (who unlike United States Marshals in continental United States are also peace officers and constables and are charged with the enforcement of law and the maintenance of order within the Territory) who are paid wholly from Federal funds appropriated annually by Congress; municipal police forces, the cost of which is defrayed by a general tax imposed upon municipal prop-

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[1] Report of Delegate E. L. Bartlett, Delegate to Congress from Alaska, October 26, 1949.

erty for that purpose (approximately 75% of the permanent population of the Territory resides within the limits of some municipality); the Territorial Highway Patrol, the cost of maintaining which is defrayed from a special fund in the Territorial Treasury which is supported by a tax of 2c per gallon on all motor fuel; the United States Fish & Wildlife Service and its employees who are paid entirely from funds appropriated annually by Congress.

4. With respect to public health the situation is similar to that of the law and order agencies described above. The territorial Department of Health is financed almost entirely by Federal funds and Congress is presently appropriating earmarked funds for the Territory for public health purposes at the rate of almost $3,000,000 per biennium.

Measured by these, the specific facts, the generalizations set forth in the brief of *amicus curiae* appear to be somewhat exaggerated.

ARGUMENT

The Following Arguments Advanced by *Amicus Curiae*, and to Some Extent by Appellee, Do Not Furnish Adequate Legal Support for the Challenged Provisionss of the Alaska Net Income Tax Act and Do Not Answer the Contentions Made by Appellant in its Opening Brief.

A. That the Organic Act Vested the Legislature of Alaska with the Plenary Taxing Power of Congress Over the Territory.

It is here suggested by *amicus curiae* that the Organic Act of Alaska, Act of August 24, 1912, c. 387, par. 1, 37 Stat. 512, 48 U.S.C.A. par. 21 *et seq.* conferred upon the Territorial legislature all of the taxing power which Congress possessed and that, therefore, the only limitations upon the taxing au-

thority of the Territorial legislature are the limitations upon the taxing power of Congress. *Alaska Fish Co. v. Smith,* 255 U. S. 44, *Pacific Fisheries v. Alaska,* 269 U. S. 269, and *Kitagawa v. Shipman,* 54 F. (2d) 313, cert. den. 286 U. S. 543, are cited in support of this proposition. However, analysis of the opinions in these cases will readily disclose that legislative authorizations contained in Territorial organic acts similar to the Alaska Organic Act have been construed to confer upon territorial legislatures powers of legislation, including taxation, analogous to those possessed by state legislatures.[2] Implicit in this view is the recognition of the desirability of limiting the legislative powers of territorial legislatures in the same manner and to the same extent as in the case of state legislatures. That is a far cry from the view of *amicus curiae* that the Territory possesses "a legislative power identical with the full power to tax inherent in Congress over a territory," and it certainly does not establish that even if the legislature possessed such power it could delegate it back to Congress. Surely Congress could not delegate to the legislature or any other body the responsibility of making federal laws.

B. That the Challenged Statute Does Not Improperly Delegate to Congress the Legislative Power of the Territory.

The brief of *amicus curiae,* and to some extent that of appellee (page 14), concedes that the authorities cited by appellant in its opening brief[3] uniformly hold that attempts to delegate legislative functions in circumstances parallel to those presented by the statute here in question are invalid

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[2] *Hornbuckle v. Toombs,* 18 Wall. 648, 655:

"The powers thus exercised by the Territorial legislatures are nearly as extensive as those exercised by any State legislature."

[3] See pp. 16, 17 of appellant's opening brief.

and have the effect of making the statute invalid. No apposite authorities are cited to the contrary and the briefs content themselves with four wholly unconvincing arguments in an attempt to divert attention from the clear-cut mandate of the decided cases holding such attempted delegations to be invalid.

1. That the Alaska Net Income Tax Act attempted to adopt by reference only existing provisions of the Internal Revenue Code.

This statement is literally a contradiction in terms of the express language of the statute and finds no support in any of the cases cited by appellee or by *amicus curiae*. Indeed, much of the argument in other portions of these briefs is directed to an explanation of the practical advantages of a Territorial income tax law which automatically conforms with the Federal income tax law. Unless words have lost their ordinary meaning, it must readily be conceded that the Territorial legislature attempted to adopt by reference not only the Internal Revenue Code as it then existed but the Internal Revenue Code "as hereafter amended."

2. That there are persuasive political reasons for recognizing the validity of such an attempt at delegation.

The question before this Court is not whether there are good reasons why the Territorial legislature should be placed in a position where it could incorporate by reference future amendments of the Internal Revenue Code but whether, in the present state of the law, it is permissible for the legislature to do this. Certainly the Congress and the people of the United States are the proper forums in which to urge the desirability of this objective, and it is authority in that field to

which *amicus curiae* resorts rather than apposite authorities in the judicial field. Regardless of views about conceptualism this is a line of demarcation which all courts have carefully observed and no proposition is better established in our law than that which confines the litigant to his forum and forbids consideration of those matters of policy which transcend the judicial function.[4] Thus, the reports of congressional committees considering the advisability of legislation designed to implement uniform federal-state taxation and books and articles published in support of that objective do not in any way weaken or detract from the cases which declare that such an attempt at delegation as that presented by the Alaska statute cannot stand.

There are cogent reasons for the adherence of the courts to the basic proposition. The real objection to an attempt at delegation such as that involved in the present controversy is the fact that it is inconsistent with the responsibilities of representative government in a republic such as ours. Underlying the condemnation of such attempted delegation is the firm conviction that in a representative form of government those who have been chosen by the people to act for them should not be permitted to abdicate that responsibility by merely referring it to another body operating independently and not as the representatives of the constituency. When the cases have spoken of "sovereignty" as the reason for the rule it has been a verbal shortcut (entirely apposite in the case of states) to the expression of this more fundamental reason.[5]

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[4] *Iselin v. United States,* 270 U. S. 245.

[5] *State v. Intoxicating Liquors,* 121 Me. 438, 117 A. 588; *Ruggles v. Collier,* 43 Mo. 353. In the latter case the court said:

> "Legislative power implies judgment and discretion upon the part of those who exercise it, and a special confidence and trust upon those who confer it."

As applied to the Territory of Alaska there is no greater justification for recognizing an abdication by the elected representatives of the residents of Alaska to the Congress, none of the members of which are elected by the residents of the Territory, than in the case of states. It would, indeed, be ironic to say in one breath, as the courts have, that the Organic Act for territories creates, in effect, an autonomy and a legislature with powers and authorities paralleling those of states and in the next breath to deny that the same responsibilities exist for determining purely local legislation.

3. That appellant has no standing in Court to raise the objection of invalid attempt to delegate.

In the face of *Allen v. Regents of the University System of Georgia,* 304 U. S. 439, we do not understand how this proposition can seriously be urged in this case. In that case the University of Georgia and the Georgia School of Technology acting through the Board of Regents, challenged the validity of the Federal Admissions Tax imposed upon admissions to athletic events, to be paid by the purchaser of the admission and required to be collected by the seller of the admission and subsequently paid over to the Collector of Internal Revenue. To the objection that the Board of Regents had no standing to challenge the taxing act as applied to the state schools, the court said:

> "We hold that the bill states a case in equity, as, upon the showing made, the respondent was unable by any other proceeding adequately to raise the issue of the unconstitutionality of the government's effort to enforce payment."

Similarly, in the present case, appellant is required to collect a tax from its employees and to pay that tax over to

the Territory. Severe penalties are provided for failure to comply with these requirements. The Territory had demanded payment of the tax from appellant and had threatened to proceed with the imposition of penalties upon appellant's refusal. Meanwhile, appellant had been enjoined from paying over to the Territory the tax withheld on the wages of its seamen. It, therefore, became necessary for appellant to test the validity of the statute in which the withholding requirement was contained. As the Supreme Court said in the *Allen* case "upon the showing made," the appellant was unable by any other proceeding adequately to raise the issue of the validity of the statute.

4. That the severability clause may properly be applied to save the statute by eliminating the references to future amendments of the Internal Revenue Code.

As applied to this portion of the statute, we think there is no basis whatever for the argument that if the legislature had foreseen the invalidity of the incorporation by reference of future amendments to the Internal Revenue Code, it would have intended the balance of the statute to remain in effect. As *amicus curiae* has so ably shown (pages 21-30) the purpose of the incorporation by reference was to achieve economy and simplicity for the Territorial income tax law and this could only result where the Federal income tax returns and the Federal audits could be used each year as the basic tax computation. If the rule of severability were applied this result could not be attained because, following any change in the Federal income tax law, there would be no basic computation which the Territory could use under its statute to fix the amount of tax. Obviously, then, if the legislature had foreseen such a consequence it would have enacted an income tax law like those of Hawaii and Puerto Rico, pat-

terned after the Federal income tax law, and which could stand independently on its own feet.

C. That the Challenged Statute Does Not Improperly Delegate to Administrative Officers the Legislative Power of the Territory.

1. That the statute makes no improper delegation to the United States Commissioner of Internal Revenue.

Section 3 of the statute provides that *unless and until* the Territorial Tax Commissioner promulgates regulations of his own the regulations of the Commissioner of Internal Revenue shall be the regulations for the Territory. Hence, in the first instance, the Federal regulations do necessarily and automatically become the local regulations. Moreover, the regulations which the Act seeks to incorporate by reference are those presently existing and those hereafter promulgated. Taken together with the attempted incorporation by reference of future amendments to the Internal Revenue Code this "is delegation running riot." Possibly the incorporation by reference of the regulations of the Commissioner of Internal Revenue standing alone would not constitute an improper delegation as suggested by the Supreme Court of Puerto Rico in *Irizarry v. District Court,* 64 P.R.R. 90, cited in the brief of *amicus curiae,* but when considered in connection with the delegation to Congress the entire scheme exceeds the permissible limits of delegation.

2. That the statute makes no improper delegation to the Territorial Commissioner of Taxation.

The brief of *amicus curiae* with respect to this point falls considerably short of meeting the issue. Appellant's conten-

tion is simply that a legislature cannot delegate to an administrative officer the authority and responsibility of creating statutes of limitations which is exclusively the function of the legislature, or delegate to the Administrator the responsibiliy for determining the legality of tax assessments and collections, which is the function of the judiciary. The cases of *Yakus v. United States,* 321 U. S. 414, and *Bowles v. Willingham,* 321 U. S. 503, cited by *amicus curiae,* involving the Emergency Price Control Act are not in any manner inconsistent with those propositions. The Emergency Price Control Act, as pointed out by the Supreme Court in those cases, contained its own statute of limitations and, with respect to the adoption of regulations to be promulgated pursuant to the Act, expressly provided for quasi-judicial hearings before the Administrator and review in the Emergency Court of Appeals, and if need be, the Supreme Court, before the detailed regulations became effective. Thus, the Act of Congress considered in those cases itself supplied the precise provisions of law which are here attempted to be delegated to the Territorial Tax Commissioner.

D. That the Challenged Statute Is Not Invalid for Indefiniteness or Uncertainty.

We agree with *amicus curiae* that a taxing act is not invalid because its terms may in the future be modified. Nevertheless, we still submit that when neither the Territory, nor the taxpayers subject to the Territorial income tax, have any control whatever over the body to which has been delegated the function of making the law then indefiniteness and uncertainty results so far as both the Territory and its taxpayers are concerned.

E. That the Challenged Statute Does Not Violate the Uniformity Clause of the Organic Act.

With all deference to the Court of Appeals for the First

Circuit and its opinions in the cases of *Ballester-Ripoll v. Court of Tax Appeals of P.R.,* 142 F. (2d) 11, *South Puerto Rico Sugar Co. v. Buscaglia,* 154 F. (2d) 96, and *Rullan v. Buscaglia,* 168 F. (2d) 401, cited by *amicus curie,* we submit that the better reasoned view is that the uniformity requirement of the Alaska Organic Act which is set forth in Section 9 of the Act as a limitation upon the taxing power of the Territory, means precisely the same thing as parallel provisions of state constitutions. The reason for this is apparent. In enacting organic acts for territories Congress is taking the first step toward ultimate statehood and it seems utterly incongruous to suppose that in taking its place along with the other local subdivisions of the United States it was intended that the Territorial power of taxation should be different from those of states. In this light the authorities cited by appellant in its opening brief (page 22) are clearly in point.

There was no Federal graduated net income tax law in 1912 when the Organic Act for Alaska was enacted. The decision of the Supreme Court in *Pollock v. Farmers Loan & Trust Company,* 157 U. S. 429, was still fresh in the mind of Congress and the Sixteenth Amendment was not yet adopted. Therefore, to say that Congress intended to confer upon the Territory the power to enact a graduated net income tax is unbelievable. If, subsequently, Congress desired to extend this power to the Territory it could have done so by a simple amendment to the Organic Act. The omission to do so will not be supplied by the judiciary. *Iselin v. United States,* 270 U. S. 245; *L. P. Steuart & Bro. v. Bowles,* 322 U. S. 398.

F. That the Criticized Classifications Made by the Statute Were Well Within the Area of Legislative Discretion, and Were Not Arbitrary Nor in Denial of Due Process.

It is probably true, as *amicus curiae* indicates, that the Civil Rights Act incorporating all of the limitations of the

Fourteenth Amendment with respect to taxation and expressly extending those limitations to territories as well as states does not actually add anything to the limitations which the courts have, without reference to that Act, recognized and applied to territorial tax legislation. We think the generalization "palpably arbitrary" has actually been applied in such a manner as to strike down taxing statutes which discriminate in favor of one as against another of the same class, or, stated differently, where no reasonable basis for the discrimination appears. However, if that is not the proper view of the "palpably arbitrary" test then we renew our contention that the Civil Rights Act which has been overlooked in other territorial tax cases is applicable here and requires the present statute to meet the test of the Fourteenth Amendment.[6]

At this point we must invite attention to an obvious, although doubtless inadvertent, error in the fact statement made by *amicus curiae* with respect to appellant's employees who are subject to the withholding provisions of the Alaska statute. The brief states that "appellant's employees were either residents of Alaska, with respect to whom no question of apportionment is involved, or seamen, in whose case an apportionment formula is expressly provided." This is, of course, contrary to the record which clearly establishes a third group of employees, i.e., shore-side employees resident

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[6] In *Martinsen v. Mullaney,* the District Court for the Territory of Alaska, First Division, No. 6095-A, July 29, 1949 (subsequent to the decision by that court in the present case) recognized the applicability of the Civil Rights Act to Territorial tax legislation and invalidated the tax there in question upon the ground that the discrimination involved violated the requirements of that Act which were, at least, as restrictive as the Fourteenth Amendment.

See, also, the decision of this Court in *County of San Mateo v. Southern Pacific Railway Co.,* 13 F. 145.

in Seattle who annually go to the Territory and perform services therein for appellant (R. 90).

Bearing these considerations in mind it is clear that the question of the validity of the apportionment formula contained in Section 5-B of the Alaska statute and the failure to provide any allocation for these employees of appellant is clearly before the Court in this case, and just as clearly neither appellee nor *amicus curiae* have advanced any conceivable basis for that discrimination. The fact is that none exists. Possibly this was the result of inadvertence, but whatever the cause the statute must fail because of the discrimination.

Similarly, there is no conceivable reason why taxpayers enjoying the benefits of net operating loss carry-overs pursuant to Section 122 of the Internal Revenue Code should, in the present taxable year, receive different treatment under the Alaska law than those who did not have such net operating losses.

The same is true with respect to the unused capital loss carry-over provided for by Section 117(e) of the Internal Revenue Code.

G. That the Provision for Suspension of Licenses to Do Business as a Penalty for Non-Payment of the Income Tax Was Not Unconstitutional.

As a practical proposition we cannot see what difference it makes whether the law provides for forfeiture of the Territorial license to do business upon non-payment of tax or whether the law provides that the payment of the tax is a condition to the carrying on of business in the Territory. In either event the payment of the tax is a condition to carrying on interstate commerce and the fact that the impact of

the condition will be felt by the taxpayer only after the first tax payment date has arrived does not get around the rule which was summarized in *Memphis Natural Gas Co. v. Stone,* 334 U. S. 314.

CONCLUSION

For the foregoing reasons, it is respectfully submitted: (1) that the decree of the district court should be reversed to the extent that it holds that chapter 115, Session Laws of Alaska, 1949, is a valid Act; that the term "continental shelf" as used in section 5-B(1) thereof may be severed from the Act without affecting the remainder of the Act; and that section 16 of chapter 115, Session Laws of Alaska, 1949, ratified and confirmed the withholdings of income taxes made pursuant to chapter 3 of the Laws of the Extraordinary Session, Alaska, 1949, and (2) that the case should be remanded to the Court for entry of a decree permanently enjoining appellee as prayed for in the original and supplemental complaints filed herein.

Respectfully,

BOGLE, BOGLE & GATES
FRANK L. MECHEM,
Central Building,
Seattle, Washington.

FAULKNER, BANFIELD & BOOCHEVER
H. L. FAULKNER,
Juneau, Alaska.
For Appellant.

November, 1949.

No. 12305

United States
Court of Appeals
For the Ninth Circuit.

COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

vs.

EDWARD M. MILLS,
Respondent.

Transcript of Record

Upon Petition to Review a Decision of the Tax Court of the United States

Phillips & Van Orden Co., 870 Brannan Street, San Francisco, Calif.

No. 12305

United States
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vs.

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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in italic; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in italic the two words between which the omission seems to occur.]

APPEARANCES

For Petitioner:

SIGVALD NIELSON, ESQ.,
HARRY R. HORROW, ESQ.,
DOUGLAS ERSKINE, ESQ.,
PHIL C. NEAL, ESQ.

For Respondent:

CHARLES W. NYQUIST, ESQ.

Docket No. 12316

EDWARD M. MILLS,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

DOCKET ENTRIES

1946

Oct. 16—Petition received and filed. Taxpayer notified. Feed paid.

Oct. 16—Request for hearing at San Francisco filed by taxpayer.

Oct. 23—Copy of petition served on General Counsel.

Nov. 27—Answer filed by General Counsel.

Dec. 6—Copy of answer served on taxpayer. San Francisco, Calif.

1947

Mar. 28—Hearing set May 26, 1947 at San Francisco, Calif.

May 6—Joint motion for consolidation with docket 13032 and place on calendar at San Francisco, Calif., commencing 5/26/47 filed. 5/7/47 granted.

May 26—Hearing had before Judge Johnson on Merits. Stipulation of facts filed. Petitioner's brief due 7/10/47—respondent's 8/25/47—reply 9/24/47.

June 16—Transcript of hearing of 5/26/47 filed.

July 8—Motion for extension to August 10, 1947, to file brief filed by taxpayer. 7/9/47 granted.

Aug. 11—Motion for extension to Aug. 25, 1947, to file brief filed by taxpayer. 8/12/47 granted.

Aug. 13—Appearance of Phil C. Neal as counsel filed.

Aug. 25—Brief filed by taxpayer. 8/26/47 copy served.

Oct. 3—Reply brief filed by General Counsel.

Nov. 6—Motion for extension to Nov. 25, 1947, to file reply brief filed by taxpayer. 11/6/47 granted.

Nov. 24—Reply brief filed by taxpayer—copy served.

1949

Mar. 28—Findings of fact and opinion rendered, Johnson J. Decision will be entered for petitioner. 3/29/49 copy served.

1949

Mar. 28—Decision entered Johnson J. Div. 10.

June 21—Petition for review by U. S. Court of Appeals, 9th Circuit, filed by General Counsel.

June 30—Proofs of service filed (2).

July 7—Statement of points filed by General Counsel with statement of service by mail thereon.

July 7—Notice re contents of record on review filed by General Counsel with statement of service by mail thereon.

Docket No. 13032

EDWARD M. MILLS,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

DOCKET ENTRIES

1947

Feb. 11—Petition received and filed. Taxpayer notified. Fee paid.

Feb. 11—Copy of petition served on General Counsel.

Feb. 11—Request for Circuit hearing in San Francisco filed by taxpayer.

1947

Mar. 19—Answer filed by respondent.

Mar. 24—Copy of answer served on taxpayer—San Francisco, Calif.

May 6—Joint motion for consolidation with docket 12316 and place on calendar at San Francisco, Calif., commencing 5/26/47 filed. 5/7/47 granted.

May 7—Hearing set May 26, 1947, at San Francisco, Calif.

May 26—Hearing had before Judge Johnson on merits. Stipulation of facts filed. Petitioner's brief due 7/10/47—respondent's 8/25/47—reply 9/24/47.

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The Tax Court of the United States

Docket No. 12316

EDWARD M. MILLS,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION

The above-named petitioner hereby petitions for a redetermination of the deficiencies set forth by the Commissioner of Internal Revenue in his notice of deficiency (MT-ET-GT-257-43-44-First California—Donor, Edward M. Mills) dated August 9,

1946, and as a basis for this proceeding alleges as follows:

1. The petitioner is an individual with his business addressed at 343 Sansome Street, San Francisco, California. The returns for the periods here involved were filed with the Collector of Internal Revenue for the First District of California.

2. The notice of deficiency (a copy of which is attached hereto and marked "Exhibit A") was mailed to petitioner on August 9, 1946.

3. The taxes in controversy are gift taxes for the calendar years 1943 and 1944 and the amounts in controversy are $5,032.45 for the year 1943 and $3,157.46 for the year 1944.

4. The determination of taxes set forth in the notice of deficiency is based upon the errors of the respondent in including the sum of $25,366.44 in petitioner's total gifts for the year 1943 and the sum of $17,033.14 in petitioner's total gifts for the year 1944.

5. The facts upon which petitioner relies are as follows:

(a) At all times herein mentioned and since July 29, 1927, petitioner and Edna Mills were, and they now are, husband and wife;

(b) At all times herein mentioned and since July 29, 1927, petitioner and Edna Mills were, and they now are, residents of the State of California;

(c) During the year 1939, petitioner and Edna Mills mutually agreed to divide equally the community property then owned by them and to con-

vert their shares of such community property into their respective separate properties in equal shares, and they further agreed that all property and income thereafter to be received by them which might otherwise be community property or income would be their respective separate properties in equal shares;

(d) During the year 1943, petitioner and Edna Mills received the sum of $50,732.28 as compensation for the personal services of petitioner, of which, by virtue of the agreement mentioned in subparagraph (c) of this paragraph 5, $25,366.44 was received as the separate income and property of Edna Mills, and the same amount was received as the separate income and property of petitioner;

(e) During the year 1944, petitioner and Edna Mills received the sum of $34,066.28 as compensation for the personal services of petitioner, of which, by virtue of the agreement mentioned in subparagraph (c) of this paragraph 5, $17,033.14 was received as the separate income and property of Edna Mills, and the same amount was received as the separate income and property of petitioner; and

(f) During the years 1943 and 1944, petitioner had no right, title or interest in or to said sum of $25,366.14 or said sum of $17,033.14 received by Edna Mills, and made no transfers of either of said sums during said years, and if any transfers of either of said sums were made, such transfers were based on a full and adequate consideration in money or money's worth.

Wherefore, petitioner prays that this court may hear this proceeding and determine that there are no deficiencies in gift taxes due from petitioner for the calendar years 1943 and 1944.

Dated: San Francisco, California, October 10, 1946.

/s/ SIGVALD NIELSON,
/s/ HARRY R. HORROW,
/s/ DOUGLAS ERSKINE,
Counsel for Petitioner.

State of California,
City and County of San Francisco—ss.

Edward M. Mills, being duly sworn, says that he is the petitioner above-named; that he has read the foregoing petition, or had the same read to him, and is familiar with the statements contained therein, and that the statements contained therein are true, except those stated to be upon information and belief, and that those he believes to be true.

/s/ EDWARD M. MILLS.

Subscribed and sworn to before me this 10th day of October, 1946.

[Seal] /s/ GERALDINE D. COHEN,
Notary Public in and for the City and County of San Francisco, State of California.

My commission expires Jan. 11, 1949.

EXHIBIT A

IRA:ET:GT:90-D-LAB

Aug. 9, 1946

MT-ET-GT-257-43-44-First California
Donor—Edward M. Mills

Mr. Edward M. Mills
343 Sansome Street
San Francisco, California

Dear Mr. Mills:

You are advised that the determination of your gift tax liability for the calendar years 1943 and 1944 discloses a deficiency of $8,189.91 as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiency mentioned.

Within 90 days (not counting Saturday, Sunday or a legal holiday in the District of Columbia as the 90th day) from the date of the mailing of this letter, you may file a petition with The Tax Court of the United States at its principal address for a redetermination of the deficiency.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to the Internal Revenue Agent in Charge, 7th Floor, 74 New Montgomery Street, San Francisco, California for the attention of Conference Section. The signing and filing of this form will expedite the closing of the return by permitting an early assessment of the deficiency, and will prevent the

accumulation of interest, since the interest period terminates 30 days after filing the form, or on the date assessment is made, whichever is earlier.

Very truly yours,

JOSEPH D. NUNAN, JR.,
Commissioner,
By F. M. HARLESS,
Internal Revenue Agent in
Charge.

Enclosures:
Statement
Form of Waiver

GIFT TAX

San Francisco
IRA:ET:GT:90-D
LAB
MT-ET-GT-257-43-44-First California
Donor—Edward M. Mills
Calendar years—1943 and 1944

STATEMENT

Gift Tax Years	Liability	Assessed	Deficiency
1943	$5,032.45	0.00	$5,032.45
1944	3,157.46	0.00	3,157.46
Total	$8,189.91		$8,189.91

In making this determination of your Federal gift tax liability for the years 1943 and 1944, careful consideration has been given to the protest dated April 23, 1946.

A copy of this letter and statement has been mailed to your representative, Mr. Harry R. Horrow, 225 Bush Street, San Francisco, 4, California.

Adjustment to Net Gifts
Year: 1943

Schedule A of return—

	Returned	Determined
(a) Total gifts, other than charitable, etc., 1943	0.00	$25,366.44
(b) Less: Total exclusions	0.00	3,000.00
Total included amount of gifts	0.00	$22,366.44

Schedule B of return—		
Total charitable, etc., gifts	0.00	0.00
Less: total exclusions	0.00	0.00
Included amount of charitable, etc., gifts	0.00	0.00
Total all gifts	0.00	$22,366.44
Less: specific exemption	0.00	0.00
Net gifts, 1943	0.00	$22,366.44

Donor—Edward M. Mills Statement

Explanation of Adjustments
Year: 1943

	Returned	Determined
Schedule A of return—		
Additional item—Gift to wife, Edna Mills	$ 0.00	$25,366.44
Exclusions	0.00	3,000.00
	$ 0.00	$22,366.44

(a) It has been determined that one-half of your salary, or $25,366.44 (½ of $50,732.88) which was converted to separate property of your wife during the calendar year 1943, constitutes a taxable gift within the meaning of Article 86.2(c) of Regulations 108.

(b) One exclusion of $3,000.00 is allowed with respect to the gift made.

Computation of Tax
Year: 1943

	Returned	Determined
1. Net gifts for 1943	$ 0.00	$ 22,366.44
2. Total gifts for preceding years	102,407.11	142,407.11
3. Total net gifts	$102,407.11	$164,773.55
4. Tax on total net gifts	0.00	$ 30,099.05
5. Tax on net gifts for preceding years	0.00	25,066.60
6. Tax on net gifts for 1943	$ 0.00	$ 5,032.45
7. Total tax assessed for 1943		0.00
8. Deficiency, 1943		$ 5,032.45

Donor—Edward M. Mills Statement

Adjustment to Net Gifts for Prior Years

	Returned	Determined
Net gifts for prior years	$102,407.11	$142,407.11

Explanation of Adjustments to Net Gifts for Prior Years

The determination of the amount of net gifts for prior years is based on the amount previously determined as total net gifts in connection with your return for the calendar year 1941.

Adjustments to Net Gifts
Year: 1944

Schedule A of return—	Returned	Determined
(a) Total gifts, other than Charitable, etc., 1944	$ 0.00	$17,033.14
Less: total exclusions	3,000.00	3,000.00
Total included amount of gifts..	0.00	$14,033.14
Schedule B of return—		
Total charitable, etc., gifts	$ 0.00	0.00
Less: total exclusions	0.00	0.00
Included amount of charitable, etc., gifts	0.00	0.00
Total all gifts	0.00	$14,033.14
Less: Specific exemption	0.00	0.00
Net gifts, 1944	$ 0.00	$14,033.14

Donor—Edward M. Mills — Statement

Explanation of Adjustments
Year: 1944

Schedule A of return—	Returned	Determined
Additional item—Gift to Wife, Edna Mills	$ 0.00	$17,033.44
Exclusions	$3,000.00	3,000.00
	$ 0.00	$14,033.14

(a) It has been determined that one-half of your salary, or $17,033.14 (½ of $34,066.28) which was converted to separate property of your wife during the calendar year 1944, constitutes a taxable gift within the meaning of Article 86.2(c) of Regulations 108. One exclusion of $3,000.00 is allowed with respect to the gift made.

Computation of Tax
Year: 1944

	Returned	Determined
1. Net gifts for 1944	$ 0.00	$ 14,033.14
2. Total net gifts for prior years	142,407.11	164,773.55
3. Total net gifts	$142,407.11	$178,806.69
4. Tax on total net gifts	0.00	33,256.51

5. Tax on gifts for prior years	0.00	30,099.05
6. Tax on net gifts for 1944	$ 0.00	$ 3,157.46
7. Total tax assessed for 1944		0.00
8. Deficiency		$ 3,157.46

Received and filed Oct. 16, 1946, T.C.U.S.

[Title of Tax Court and Cause.]

Docket No. 12316

ANSWER

Comes now the Commissioner of Internal Revenue, respondent above named, by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, and for answer to the petition filed by the above-named petitioner, admits, denies and alleges as follows:

1. Admits that the petitioner is an individual with his business address at 343 Sansome Street, San Francisco, California; denies the remaining allegations contained in paragraph 1 of the petition.

2, 3. Admits the allegations contained in paragraphs 2 and 3 of the petition.

4. Denies that the determination of tax set forth in the notice of deficiency is based upon error as alleged in paragraph 4 of the petition.

5 (a), (b). Admits the allegations contained in subparagraphs (a) and (b) of paragraph 5 of the petition.

(c) Denies the allegations contained in subparagraph (c) of paragraph 5 of the petition.

(d) Denies the allegations contained in subparagraph (d) of paragraph 5 of the petition, and alleges that during the year 1943 petitioner received the sum of $50,732.88.

(e) Admits that during the year 1944 petitioner received the sum of $34,066.28; denies the remaining allegations contained in subparagraph (e) of paragraph 5 of the petition.

(f) Denies the allegations contained in subparagraph (f) of paragraph 5 of the petition.

6. Denies generally and specifically each and every allegation in the petition not hereinbefore admitted, qualified, or denied.

Wherefore, it is prayed that the Commissioner's determination be approved and the petitioner's appeal denied.

/s/ J. P. WENCHEL,
Chief Counsel, Bureau of
Internal Revenue.

Of Counsel:
B. H. NEBLETT,
Division Counsel,
T. M. MATHER,
W. J. McFARLAND,
Special Attorneys,
Bureau of Internal Revenue.

Received and filed Nov. 27, 1946, T.C.U.S.

[Title of Tax Court and Cause.]

Docket No. 13032

PETITION

The above-named petitioner hereby petitions for a redetermination of the deficiencies set forth by the Commissioner of Internal Revenue in his notice of deficiency (MT-ET-GT-45-257-First California —Donor, Edward M. Mills) dated November 20, 1946, and as a basis for this proceeding alleges as follows:

1. The petitioner is an individual with his business address at 343 Sansome Street, San Francisco, California. The return for the period here involved was filed with the Collector of Internal Revenue for the First District of California.

2. The notice of deficiency (a copy of which is attached hereto and marked "Exhibit A") was mailed to petitioner on November 20, 1946.

3. The tax in controversy is gift tax for the calendar year 1945 and the amount in controversy is $2,807.77.

4. The determination of tax set forth in the notice of deficiency is based upon the following errors:

(a) The respondent erred in including the sum of $15,479 in petitioner's total gifts for the year 1945.

(b) The respondent erred in determining that petitioner made net gifts for preceding years in the amount of $178,806.69 or in any amount in excess of $142,407.11.

5. The facts upon which petitioner relies are as follows:

(a) At all times herein mentioned and since July 29, 1927, petitioner and Edna Mills were, and they now are, husband and wife;

(b) At all times herein mentioned and since July 29, 1927, petitioner and Edna Mills were, and they now are, residents of the State of California;

(c) During the year 1939, petitioner and Edna Mills mutually agreed to divide equally the community property then owned by them and to convert their shares of such community property into their respective separate properties in equal shares, and they further agreed that all property and income thereafter to be received by them which might otherwise be community property or income would be their respective separate properties in equal shares;

(d) During the year 1943, petitioner and Edna Mills received the sum of $30,958 as compensation for the personal services of petitioner, of which, by virtue of the agreement mentioned in subparagraph (c) of this paragraph 5, $15,479 was received as the separate income and property of Edna Mills, and the same amount was received as the separate income and property of petitioner;

(e) During the year 1945, petitioner had no right, title, or interest in or to said sum of $15,479 received by Edna Mills, and made no transfer of said sum during said year, and if any transfer of said sum was made, such transfer was based on a full and adequate consideration in money or money's worth;

(f) In arriving at the deficiency involved in this proceeding, respondent determined that petitioner made net gifts for preceding years in the amount of $178,806.69. Said determination conforms with the amount determined by the respondent to be the total net gifts made by petitioner for the calendar year 1944, which determination is the subject of a petition before this Court bearing docket No. 12316. Petitioner's gift tax return for the year 1945 reported net gifts for preceding years in the amount of $142,407.11. Petitioner alleges that the net gifts made by him for preceding years was not in excess of said amount of $142,407.11.

Wherefore, petitioner prays that this Court may hear this proceeding and determine that there is no deficiency in gift tax due from petitioner for the calendar year 1945.

Dated: San Francisco, California, February 6, 1947.

/s/ SIGVALD NIELSON,
/s/ HARRY R. HORROW,
/s/ DOUGLAS ERSKINE,
Counsel for Petitioner.

State of California,
City and County of San Francisco—ss.

Edward M. Mills, being duly sworn, says that he is the petitioner above named; that he has read the foregoing petition, or had the same read to him, and is familiar with the statements contained therein, and that the statements contained therein

are true, except those stated to be upon information and belief, and that those he believes to be true.

/s/ EDWARD M. MILLS.

Subscribed and sworn to before me this 3rd day of February, 1947.

[Seal] /s/ GERALDINE D. COHEN,

Notary Public in and for the City and County of San Francisco, State of California.

My commission expires Jan. 11, 1949.

EXHIBIT A

Office of
Commissioner of Internal Revenue

Address reply to Commissioner of Internal Revenue and refer to MT-ET-GT-45-257-1st California

Donor—Edward M. Mills—Nov. 20, 1946.

Mr. E. M. Mills
343 Sansome Street
San Francisco, California

Dear Mr. Mills:

The determination of your gift tax liability for the calendar year 1945 discloses a deficiency of $2,807.77 as shown in the attached statement.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiency or deficiencies mentioned.

Within ninety days (not counting Saturday, Sunday or a legal holiday in the District of Columbia

as the ninetieth day) from the date of the mailing of this letter, you may file a petition with The Tax Court of the United States, at its principal address, Washington 25, D. C., for redetermination of the deficiency or deficiencies.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to this office. The signing and filing of this form will expedite the closing of your return(s) by permitting an early assessment of the deficiency or deficiencies, and will prevent the accumulation of interest, since the interest period terminates thirty days after filing the form, or on the date assessment is made, whichever is earlier.

Very truly yours,
JOSEPH D. NUNAN, JR.,
Commissioner.
By /s/ D. S. BLISS,
Deputy Commissioner.

Enclosures: 7585
Statement
Form of waiver

MT-ET-GT-45-257-1st California
Donor—E. M. Mills

STATEMENT

Calendar year 1945

The determined deficiency is computed as follows:

	Returned	Determined
Total gifts, 1945, other than charitable, etc., gifts	$ 5,400.00	$ 20,879.00
Less exclusions	3,000.00	6,000.00
Amount of gifts included	2,400.00	14,879.00

Less specific exemption	0.00	0.00
Net gifts, 1945	2,400.00	14,879.00
Net gifts for preceding years	142,407.11	178,806.69
Total net gifts	144,807.11	193,685.69
Tax on total net gifts	$ 25,606.60	$ 36,604.28
Tax on net gifts for preceding years	25,066.60	33,256.51
Tax on net gifts, 1945	540.00	3,347.77
Tax shown on return		540.00
Deficiency, 1945		$ 2,807.77

The determined deficiency results from the following adjustments:

Schedule A

Item 2	$ 0.00 Determined	$ 15,479.00 Returned
Exclusions	$ 6,000.00	$ 3,000.00

Schedule C

	Returned	Determined
Net gifts for preceding years	$142,407.11	$178,806.69
To balance	48,878.58	

One-half of your salary, or $15,479.00, which was converted to separate property of your wife during the calendar year 1945, is included herein as a gift pursuant to the provisions of Section 86.2(c) of Regulations 108 relating to gift tax. One exclusion of $3,000.00 is allowed in connection with this gift.

Net gifts for preceding years are increased to conform with the amount heretofore determined as total net gifts for the calendar year 1944.

Received and filed Feb. 11, 1947. T.C.U.S.

[Title of Tax Court and Cause.]

Docket No. 13032

ANSWER

Comes now the Commissioner of Internal Revenue, respondent above named, by his attorney,

J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, and for answer to the petition filed by the above-named petitioner, admits and denies as follows:

1, 2, 3. Admits the allegations contained in paragraphs 1, 2, and 3 of the petition.

4 (a), (b). Denies that the determination of tax set forth in the notice of deficiency is based upon error as alleged in subparagraphs (a) and (b) of paragraph 4 of the petition.

5 (a), (b). For lack of knowledge or information sufficient to form a belief, denies the allegations contained in subparagraphs (a) and (b) of paragraph 5 of the petition.

(c), (d), (e). Denies the allegations contained in subparagraphs (c), (d) and (e) of paragraph 5 of the petition.

(f). Admits the allegations contained in subparagraph (f) of paragraph 5 of the petition, except that respondent denies that the net gifts made by petitioner during the preceding years were not in excess of the amount of $142,407.11.

6. Denies generally and specifically each and every allegation in the petition not hereinbefore admitted, qualified, or denied.

Wherefore, it is prayed that the Commissioner's determination be approved and the petitioner's appeal denied.

/s/ J. P. WENCHEL,
Chief Counsel,
Bureau of Internal Revenue.

Of Counsel:

B. H. NEBLETT,
Division Counsel.
T. M. MATHER,
W. J. McFARLAND,
Special Attorneys,
Bureau of Internal Revenue.

Received and filed Mar. 19, 1947. T.C.U.S.

[Title of Tax Court and Cause.]

Docket Nos. 12316 and 13032

JOINT MOTION FOR CONSOLIDATION OF PROCEEDINGS AND FOR PLACING ON HEARING CALENDAR

Come now the parties to the above entitled proceedings, by their respective counsel, and move for an order of the Court to place the case of Edward M. Mills, docket No. 13032, on the hearing calendar at San Francisco, California, commencing May 26, 1947, and to consolidate the two proceedings, both in the case of Edward M. Mills, docket Nos. 12316 and 13032. In support of this motion the parties state:

1. The case of Edward M. Mills, docket No. 12316, is on the hearing calendar at San Francisco on May 26, 1947, and issue therein is the petitioner's gift tax liability for the years 1943 and 1944.

2. The case of Edward M. Mills, docket No.

13032, is not on any hearing calendar, and the issue therein is the petitioner's gift tax liability for the year 1945.

3. The two cases involve similar issues of fact and of law for different taxable years, and consolidation of the proceedings will save the time of the parties and of the Court.

Wherefore, the parties jointly pray that the Court will grant this motion.

/s/ HARRY R. HORROW,
Counsel for Petitioner.

/s/ J. P. WENCHEL,
Chief Counsel,
Bureau of Internal Revenue.

Received and filed May 6, 1947. T.C.U.S.

[Stamped]: Granted The Tax Court of the U. S. May 7, 1947.

/s/ J. E. MURDOCK,
Judge.

The Tax Court of the United States

Docket Nos. 12316, 13032

EDWARD M. MILLS,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Room 417, Appraisers Building, 630 Sansome Street, San Francisco, California. May 26, 1947, 2:00 p.m.,

(Met pursuant to notice.)

Before: Honorable Luther A. Johnson,
Judge.

Appearances:

PILLSBURY, MADISON & SUTRO,
By HARRY R. HORROW, ESQ.,
225 Bush Street,
San Francisco, California,
Appearing for the Petitioner.

CHARLES W. NYQUIST, ESQ.,
(HONORABLE J. P. WENCHEL,
Chief Counsel, Bureau of Internal Revenue),
Appearing for the Respondent.

PROCEEDINGS

The Court: The Clerk will call the first case set.

The Clerk: Dockets Nos. 12316 and 13032, Edward M. Mills.

Mr. Horrow: Ready for the Petitioner.

Mr. Nyquist: Ready for the Respondent, your Honor.

The Court: Counsel, would you like to make a brief statement of the nature of the cases? It is to be submitted, as I understand, on statement of facts. Or, is there some oral testimony?

Mr. Horrow: Harry R. Horrow appears for the Petitioner. There will be some oral statements.

Opening Statement on Behalf of the Petitioner,

By Mr. Horrow:

Mr. Horrow: These cases have been consolidated for trial, your Honor. They involve deficiencies in gift taxes for the years 1943, 1944, and 1945. The same questions are involved in each of those years. Those questions are whether the Petitioner made taxable gifts to his wife, and, if so, in what amounts.

The facts briefly are these, your Honor: In January of 1939 Petitioner and his wife were residents of California. They mutually agreed to divide the community property which they owned on December 31, 1938. They also agreed that the community property so divided would be thereafter held by each [*2] as his or her separate property.

As a part of that same agreement they mutually agreed that thereafter one half of the salaries or other compensation for personal services would

* Page numbering appearing at top of page of original certified Transcript of Record.

belong to each as his or her separate property. This agreement was carried out throughout the years 1939 to the present time. One half of the salary or other compensation for personal services has been received, one half by Mr. Mills as his separate property, and one half by Mrs. Mills as her separate property.

For the years 1939 to 1942 no gift tax returns were filed covering the receipt of one half of the compensation by Mrs. Mills. Thereafter, for the years in question, gift tax returns were filed solely for the purpose of avoiding the imposition of penalties.

The Commissioner has determined that one half of the total compensation for the personal services rendered by Mr. Mills constituted a taxable gift to Mrs. Mills during the years 1943, 1944, and 1945. He has not held that any taxable gifts were made for the years prior to 1943 and apparently it is conceded that the receipt by the wife of one half of that compensation during those years did not constitute a taxable gift.

The Commissioner in holding that taxable gifts were made to the wife for the years 1943, 1944, and 1945, relies on the regulations that are set out, Regulation 108, Section 86.2C. Those Regulations are issued under Section 1000D, which [3] came into the law in the Revenue Act of 1942. The substance of this Act is that all gifts of community property shall be considered to be gifts of the husband except to the extent that the community property was

derived either from the separate property of the wife or personal services that were rendered by the wife.

Of course, in this case it is conceded that the wife did not render any personal services.

The Petitioner contends first of all that the Regulations do not apply. They deal in terms with a division of community property, and, secondly, they do not purport to apply to transfers that were made prior to January 1, 1943, which is the effective date of Section 1000D under which the Regulations to which I referred have been issued.

It is our further contention that if the Regulations do apply, they are invalid. There are a number of questions of law that relate to that; I won't go into those at this time, your Honor, but that briefly states our case.

The Court: Does Respondent's counsel desire to make a statement?

Opening Statement on Behalf of the Respondent,

By Mr. Nyquist

Mr. Nyquist: Apparently the only actual dispute as to facts here is with respect to the exact terms of the 1939 agreement. Everything else, I believe, has been covered by [4] the stipulation and I believe the Petitioner will introduce evidence as to the terms of the agreement in 1939.

The Court: You mean by the 1939 agreement, the agreement mentioned by Petitioner's counsel with reference to the division of the property?

Mr. Nyquist: Yes, your Honor.

In that connection the stipulation covers the agreement as it applied to property which was then owned by the parties, but the stipulation of facts is silent as to the terms of the agreement as it applied to after acquired property.

Now the Respondent takes the position that there was no binding contract entered into in 1939 which effected a division of the property or earnings which the Petitioner had not at that time earned.

Respondent further believes that even assuming that the 1939 agreement may have created some sort of enforceable obligation concerning the future earnings, but nevertheless there was no completed gift, or completed transfer in 1939, that the completed gift was made in the years in which the Petitioner performed the services which produced the income and turned over half of the income to his wife as her separate property.

There is one point I would like to call to the Court's attention at this time: In Paragraph 3 of the stipulation the deficiencies as determined by the Commissioner for the years [5] 1943, 1944, and 1945 are set out. It is further stated that in his gift tax return for the years 1943 and 1944 the Petitioner inadvertently understated the total compensation for the persconal services rendered by him in those years by the amounts of $131.04 in each year. As a result of that understatement, the Commissioner in determining the amounts of the gifts and the

amounts of the tax due thereon as stated in the deficiency letter has determined amounts slightly less than the amounts that would be due under the Respondent's theory of the case if he had used the correct figures. And it is stated in it——

The Court: Whose error was it that the figures were not given correctly?

Mr. Nyquist: The error arose originally in the Petitioner's gift tax returns. I think it is explainable and it was inadvertent. But because of that error the deficiencies are slightly smaller than the amount which the Respondent now asserts and instead of going through the formalities of amending the pleadings, we have merely stated in the stipulation that the Respondent hereby asserts a claim for any increased deficiencies that may result from the Court's taking into account said corrected amounts.

I believe there will be no difficulty over that one.

Mr. Horrow: At this time, your Honor, I should like to file the stipulation of facts which have been entered into [6] these proceedings.

The Court: Stipulation of facts will be received and filed as part of the evidence of the record of the case.

Mr. Horrow: I will ask Respondent's counsel to produce the gift tax returns of Edward M. Mills for the years 1943, 1944, and 1945, and the donee's information returns for those years filed by Edna Mills.

Mr. Nyquist: I have with me the donor's re-

turns. I do not have the donee's information returns for those years.

Mr. Horrow: May it be understood, your Honor, that Petitioner could offer the original donee's returns in evidence for these years. I have copies of the returns for two of the years in question, but I thought it would be better to have the original returns in evidence.

The Court: You mean offer the original returns, then have photostatic copies substituted? Is that what you have in mind, or copies?

Mr. Horrow: I should like to offer in evidence as Petitioner's exhibits the original gift tax returns of Edward M. Mills for the years 1943, 1944, and 1945.

The Court: Without objection they will be admitted into evidence and marked Exhibits—what are they, three of them?

Mr. Horrow: Yes, your Honor.

The Court: They will be marked Exhibits 1, 2 and 3 [7] of the Petitioner.

(The returns above-referred to were received in evidence and marked Petitioner's Exhibits Nos. 1, 2, and 3.)

Mr. Horrow: I should also like to offer in evidence the donee's information returns filed by Edna Mills for the years 1943, 1944, and 1945.

The Court: Any objection?

Mr. Nyquist: In that connection I would like to ask for what purpose the donee's returns are being put in evidence?

Mr. Horrow: Those are returns that are required by law, your Honor, and they are simply to supplement the record. The donor's returns must be complemented by a donee's information return, and they are certainly relevant to the issues in these matters.

The Court: Well, the Court will admit it. I don't know what probative effect they will have, but they will be admitted into evidence.

How many?

Mr. Horrow: Three. They are not in the courtroom at the moment because Respondent's counsel does not have them in his files.

The Court: Are they going to be produced later?

Mr. Nyquist: If Petitioner wishes to put in his copies, I have no objection to them being offered.

The Court: Does Petitioner desire to do that?

Mr. Horrow: I prefer to put the originals in, your Honor.

The Court: Can they be had?

Mr. Nyquist: I can bring them over tomorrow.

The Court: They will be admitted in evidence and they can be later marked for exhibits as Petitioner's Exhibits Nos. 4, 5, and 6.

(Donee's returns above-referred to were received in evidence and marked Petitioner's Exhibits Nos. 4, 5, and 6.)

Mr. Horrow: At this time I shall call Edward M. Mills as a witness.

Whereupon,

EDWARD M. MILLS

called as a witness for and on behalf of the Petitioner, having been first duly sworn, was examined and testified as follows:

The Court: What are your initials, Mr. Mills?

The Witness: Edward M. Mills.

Direct Examination

By Mr. Horrow:

Q. Will you state your name and address for the record, Mr. Mills?

A. My business address is 343 Sansome Street; I live at Woodside. [9]

Q. Mr. Mills, I show you the stipulation of facts that has been filed in this proceeding. Will you refer to Paragraph 6 of that stipulation?

A. Yes, sir.

Mr. Horrow: This is just for your information, your Honor; it is very short.

Q. (Continuing) On or about January 1, 1939, Petitioner and Edna Mills entered into an oral agreement, one of the terms of which was an agreement to divide equally all the community property owned by them on December 31, 1938, and that thereafter each of said spouses would hold and own one half of said community property as his or her respective separate property.

Now, was there any agreement or understanding entered into between yourself and Mrs. Mills with respect to salary or compensation for services to be received? A. Yes, sir.

(Testimony of Edward M. Mills.)

Q. Will you state that understanding or agreement, Mr. Mills?

A. I had always divided my salary with my wife for many years and that was continued under this agreement.

The Court: What business were you in, Mr. Mills?

The Witness: Beg pardon?

The Court: What business were you in, Mr. Mills?

The Witness: Part of the time with the Rayonier, Incorporated and the rest of the time with Crown Zellerbach [10] Company.

The Court: What nature was it?

The Witness: Selling pulp.

By Mr. Horrow:

Q. Now with respect to the agreement to divide equally all the community property referred to in Paragraph 6, will you state whether that division took place?

A. It did, sir, month by month.

Q. I am referring, Mr. Mills, to the community property which was owned on December 31, 1938.

A. That was divided with my wife physically. She received certain securities and I kept certain securities.

Q. And were those securities placed in her name? A. Yes, sir.

Q. Were the securities which were kept as your one half of the property kept in your name?

(Testimony of Edward M. Mills.)

A. Yes, sir, in separate books and physically so.

Q. Were the securities in the name of your wife considered to be her separate property thereafter?

A. Yes, sir.

Q. And were the securities kept in your name considered to be your separate property thereafter?

A. Yes, sir.

Q. Was the same true with respect to the salary and compensation for services?

A. The salaries and compensation for services were [11] equally divided with the exception of one or two errors of Directors' fees.

Q. And that was pursuant to the agreement entered into on January, 1939?

A. It was, sir.

Q. And one half of the salaries or compensation was to be your wife's separate property?

A. That is right, sir.

Q. And one half was to be your separate property? A. Yes, sir.

Q. How long was that agreement to continue, Mr. Mills?

A. For the rest of our lives, as far as I know, sir.

Q. Was it in effect from 1939 to the present time?

A. I think so; yes, sir, I am sure.

Q. Did you have any intention of making any gifts to Mrs. Mills in 1943, 1944, and 1945?

A. No, sir.

Mr. Horrow: That is all, your Honor.

The Court: Any questions by Respondent's counsel?

(Testimony of Edward M. Mills.)

Mr. Nyquist: Yes, your Honor.

Cross-Examination

By Mr. Nyquist:

Q. Mr. Mills, you have testified generally as to your impression of the effect of the agreement between yourself and Mrs. Mills in 1939 without making any definite statements as to [12] the wording or terms of that agreement.

I would like to have you state the wording or terms of that agreement as best you can recall them.

A. Accountants and lawyers were employed at the time and she was to have half of it and I was to have half of it.

Q. Was the agreement put in writing?

A. No, sir.

Q. Was it an agreement in formal language such as a contract which a lawyer might draw up, or was it an informal agreement such as a man might ordinarly have with his wife?

Mr. Horrow: Your Honor, I object to that as being argumentative.

Mr. Nyquist: May it please the Court, we have just vague testimony concerning the agreement without any of its provisions being stated and apparently the witness is unable to recall the exact provisions of the agreement. I am trying to bring out that.

The Court: You can cross-examine and show what was said or done. I don't know whether there

(Testimony of Edward M. Mills.)

was any fixed standard by which one was made of it. I don't know if the witness would know how to pass on answering that question.

Mr. Nyquist: The point I am trying to point out is, did Mr. and Mrs. Mills sit down across the table and draw up or arrange orally an agreement?

The Court: Ask him about that and let us find out. [13] Ask the witness about that.

Mr. Nyquist: Yes, your Honor.

Q. (By Mr. Nyquist): Mr. Mills, did you and Mrs. Mills exchange formal words in the nature of an oral contract?

Mr. Horrow: Your Honor, I am sorry——

Mr. Nyquist: (Continuing) or did you—or was it merely a general understanding that was reached by you from the surrounding circumstances and over a period of time without the use of specific words?

Mr. Horrow: Your Honor, I think that calls for a conclusion. It is argumentative.

Mr. Nyquist: Your Honor, the whole testimony of this witness was a conclusion.

The Court: I think cross-examination has a pretty wide latitude. The witness can disagree or agree with him as he thinks the facts warrant.

A. The discussion—a discussion took place in the drawing of my will which occurred about that time. We decided to keep on dividing the assets 50-50, as it were.

Q. (By Mr. Nyquist): You mean it was the

(Testimony of Edward M. Mills.)

understanding between you and Mrs. Mills you would continue as you had been doing before, dividing your—— [14] A. Absolutely.

Q. And when you were asked on Direct Examination how long that was to continue, your reply was, "For the rest of our lives, as far as I know." By that did you mean there was nothing definite said at that time as to how long it was to continue?

A. No, sir; nothing definite said. It was to be a final settlement between us.

Q. Do you recall whether the phrase "salary and other compensation for personal services" was used by either you or Mrs. Mills in reaching that agreement?

A. The phrase was used, I believe, and referred to salaries and directors' fees.

Q. Did you use those words, "salary and other compensation for personal services"?

A. I don't think we used direct salaries; salaries and directors' fees alone.

The Court: I didn't understand what the witness said.

The Witness: I think we used, "salaries and directors' fees."

The Court: Instead of "salaries and other compensation" you said "salaries and directors' fees"?

The Witness: Yes, sir.

The Court: Was that the income you had at that time? [15]

The Witness: There were also returns on the investments.

(Testimony of Edward M. Mills.)

The Court: But the only salaries and directors' fees you were talking about?

The Witness: That was the only known means of compensation outside of dividends and interest.

Q. (By Mr. Nyquist): Mr. Mills, in the affidavit which you attached to your 1943 gift tax return, you stated: "And agreed that all income to be received thereafter from salary and other compensation for personal services which would otherwise have been received as our community income should be received by each as his or her separate income or property."

Mr. Horrow: Excuse me, I think if you have no objection I would like to show Mr. Mills the affidavit so he can keep in mind the language to which you have referred.

Mr. Nyquist: I have no objection.

The Court: From what are you reading?

Mr. Nyquist: I am reading from a copy of an affidavit which accompanied Mr. Mills' gift tax return from 1943 which is in evidence.

The Court: All right.

Q. (By Mr. Nyquist): When you made that affidavit in 1943, Mr. Mills, and used the phrase "salary and other compensation for personal [16] services," were you trying to quote the exact words of an agreement entered into between you and Mrs. Mills or merely a general statement of your impression of the effect of that agreement?

A. As far as I remember, Sir, there was no com-

(Testimony of Edward M. Mills.)

pensation for personal services other than directors' fees and salaries at that time.

Q. Perhaps I didn't make my question entirely clear.

The Court: I think the witness' answer was responsive. As he said a moment ago, the only thing he remembered definitely as to language used was that in specifying, salaries and directors' fees were specifically mentioned. Is that what you understood?

The Witness: Yes, your Honor.

The Court: That covered everything that came in except dividends and they didn't come under "salary or compensation"?

Q. (By Mr. Nyquist): In other words, the language used in your affidavit does not purport to be the exact language of your agreement with Mrs. Mills but merely your recollection of the substance?

A. That's right, sir.

Q. Mr. Mills, what was the occasion for this agreement in 1939?

A. I think I had been apprised of a change in income tax [17] act, whatever it was, and that the division of salaries I had been making was more or less questioned by them. I am not quite sure; that is my impression now.

Q. Was Mrs. Mills employed in 1939?

A. No, sir.

Q. And did you in 1939 contemplate she would ever be employed or have personal compensation?

(Testimony of Edward M. Mills.)

A. No, sir; I hope not!

Q. Did your 1939 agreement cover all future income to be received by either of you or merely the compensation for personal services?

A. The compensation for personal services, sir. The assets had been divided and taxes paid where necessary.

Q. Mr. Mills, it has been stipulated that each month you received your salary as an officer of Rayonier, Incorporated, in two equal monthly installments and that one of the checks each month was endorsed by you or your secretary to Mrs. Mills and deposited in her separate account.

A. I think that was the way it was done, possibly, but I never knew just what I got.

Q. I see.

Well, was it your intention that these checks that were endorsed to Mrs. Mills and deposited in her account, should become the separate property of Mrs. Mills? A. Yes, sir. [18]

Mr. Nyquist: No further questions.

The Court: Prior to the agreement that Counsel has been interrogating you about, between you and your wife, as to division, did I understand you to say it had been your practice to divide your salary with your wife before that time?

The Witness: The salary, yes, sir, entirely.

The Court: For how long a time?

The Witness: Twenty years or so, I think.

The Court: Every month, your wife would get half your salary?

(Testimony of Edward M. Mills.)

The Witness: Maybe only 15 years, but it is a long time.

The Court: That is a long time.

The Witness: Yes, sir.

The Court: There is no change in regard to this division in your agreement, but you said you made the agreement because there was a change in the law that might necessitate some formal agreement made. Was the reason on advice of counsel?

The Witness: I think so, your Honor.

The Court: In addition to your salary from the bank, did you receive any other salary?

The Witness: The only salary I received was as Director and President of the Rayonier and Vice President of Crown Zellerbach. [19]

The Court: And the other property—your stocks and bonds and securities—they had already been divided or were divided at that time?

The Witness: They were divided with the consent of the Treasury Department, I understood.

The Court: That is all.

Redirect Examination

By Mr. Horrow:

Q. Mr. Mills, prior to 1939 were there questions raised by the Bureau of Internal Revenue as to what was your separate property and what was your community property?

A. By 1929 it had been settled. Some years before questions had been raised.

Q. You meant "1939"? A. Yes, sir.

(Testimony of Edward M. Mills.)

Q. 1939. Was it your purpose in entering into this agreement in 1939 to eliminate controversy on community property? A. Yes, sir.

Q. And referring again to stipulation, Mr. Mills, Paragraph 6, the division of your community property owned on December 31, 1938, one-half of that community property was to be your wife's separate property, is that correct? A. Yes, sir.

Q. And was one-half of the salary and compensation likewise [20] to be separate property?

A. Of the salary and personal earnings?

Q. It was to be separate property?

A. Yes, it was.

Q. And you said that the agreement was to continue throughout the rest of your lives? Did you understand that you could terminate that agreement without your wife's consent?

A. No, sir.

Mr. Horrow: That is all, your Honor.

The Court: Did your wife have any earnings? Was she ever employed?

The Witness: No, sir. She brought up our children.

The Court: That is all.

Mr. Horrow: That completes Petitioner's case, your honor. Petitioner rests.

The Court: Stand aside, Mr. Mills.

Any evidence to be offered by the Respondent?

Mr. Nyquist: The Respondent rests, your Honor.

The Court: The usual time for filing briefs will be sufficient?

Mr. Horrow: If your Honor please, we would like 45 days for reply in view of the mailing situation; otherwise, briefs under the rules would be agreeable.

Mr. Nyquist: Your honor, inasmuch as I contemplate that the Petitioner intends to make an attack on the validity [21] of the Regulations, I would like to request that instead of filing simultaneous briefs, the Petitioner file his brief first, making his attack on the Regulations and then the Respondent reply.

Mr. Horrow: We have no objection to that, your Honor.

The Court: How much time would the Petitioner want to file his other brief?

Mr. Horrow: Forty-five days with 45 days for reply, if agreeable.

The Court: That is a bit longer than we usually allow. Wouldn't 30 days for reply be adequate?

Mr. Horrow: We find, your Honor, that it takes about 15 days to be served with a copy of the Respondent's brief.

The Court: Is that agreeable with the Respondent's counsel: 45 and 45?

Mr. Nyquist: As I understand it, that would be 45 days for Petitioner and 45 days thereafter for reply?

The Court: Yes. You wouldn't want any more

than 45, would you, to reply to that? It would take us to Christmas.

Mr. Horrow: No, your Honor. Forty-five and 45 and 45.

The Court: I think we better cut out that last 45. [22] Make it 45, 45 and 30.

Mr. Horrow: Thank you, your Honor.

(Whereupon, at 2:35 o'clock p.m., the hearing in the above-entitled matter was closed.)

Filed T.C.U.S. June 16, 1947. [23]

[Title of Tax Court and Cause.]

Docket No. 12316 and Docket No. 13032

STIPULATION OF FACTS

It is hereby stipulated and agreed by and between the parties hereto through their respective attorneys that the following facts shall be taken to be true and received as evidence for all purposes of this proceeding, subject to the right of either party to introduce any further evidence not inconsistent with or contrary to the facts herein stipulated.

1. The petitioner is Edward M. Mills, an individual with his business address at 343 Sansome Street, San Francisco 4, California. Petitioner's gift tax returns for the calendar years 1943, 1944, and 1945 were filed with the Collector of Internal Revenue for the First District of California.

2. The notices of deficiency involved in these proceedings were mailed to petitioner on August 9, 1946, and November 20, 1946, respectively.

3. The deficiencies determined by the Commissioner are in gift taxes for the calendar years 1943, 1944, and 1945 in amounts as follows:

1943—$5,032.45; 1944—$3,157.46; 1945—$2,807.77.

In his gift tax returns for the years 1943 and 1944 the petitioner inadvertently understated the total compensation for personal services rendered by him in such years by the amounts of $131.04 in each year, the corrects amounts being $50,863.92 for the year 1943 and $34,197.32 for the year 1944. Respondent hereby asserts a claim for any increased deficiencies that may result from the Court's taking into account said correct amounts.

4. At all times since July 29, 1927, petitioner and Edna Mills were and they now are husband and wife.

5. At all times since July 29, 1927, petitioner and Edna Mills were and they now are residents of the State of California.

6. On or about January 1, 1939, petitioner and Edna Mills entered into an oral agreement, one of the terms of which was an agreement to divide equally all the community property owned by them on December 31, 1938, and that thereafter each of said spouses would hold and own one-half of said community property as his or her respective separate property.

7. Pursuant to said agreement, the community

property owned by petitioner and Edna Mills on December 31, 1938, was equally divided. The community property on said date consisted of various stocks and bonds in the names of petitioner or petitioner and Edna Mills jointly. Pursuant to the agreement referred to in paragraph 6, one-half of said stocks and bonds were transferred to Edna Mills and were thereafter held in her name. Separate books of account were kept for petitioner and Edna Mills at all times mentioned herein. In the books of account of petitioner, the following entry dated January 1, 1939, appears: "To transfer to Edna Mills her one-half interest in the community property at December 31, 1938," followed by a list of the securities so transferred to Edna Mills, which were carried on petitioner's books of account at the amount of $270,963.13. At all times mentioned herein the petitioner maintained bank accounts in his separate name, into which was received his separate income. At all times mentioned herein Edna Mills maintained bank accounts in her separate name, into which was received her separate income.

8. Pursuant to said agreement referred to in paragraph 6 hereof, all salary and other compensation received for personal services rendered by petitioner since January 1, 1939, has been received as hereinafter set forth. No salary or other compensation has been received for personal services rendered by Edna Mills at any time mentioned herein and throughout the taxable years in ques-

tion. Since January 1, 1939, and during the years 1943, 1944, and 1945, petitioner was an officer and director of Rayonier Incorporated and a director of Crown Zellerbach Corporation. His salary as said officer was payable in equal semimonthly installments, and deductions were made therefrom for the Federal Old Age Benefit tax imposed on employees, the State of California unemployment insurance tax imposed on employees, the federal withholding tax on wages, group insurance premiums, and for the purchase of United States Savings Bonds, Series E. Checks covering these semimonthly payments of salary after said deductions were made payable to petitioner. One of said checks for each month was deposited by petitioner's secretary in the separate bank account of petitioner. The other check for each month was endorsed by petitioner's secretary on behalf of petitioner to the order of Edna Mills and deposited by petitioner's secretary in the separate bank account of Edna Mills. As used herein, the term "separate bank account" refers to an account in which the amounts on deposit are owned and held as separate property. Petitioner was covered by a group life insurance policy for which premiums were deducted from salary payments. These deductions were made in the case of the salary payments deposited in the separate account of Edna Mills. During each of the taxable years 1943, 1944, and 1945 deductions from salary payments were made for the purchase of United States Savings Bonds, Series E. Deduc-

tions for the purchase of bonds totaled $4,800 in each year, of which $2,400 was expended to purchase Series E bonds issued to petitioner in his name and $2,400 was expended to purchase Series E bonds issued to Edna Mills in her name. Checks for the director's fees were deposited in the separate bank account of petitioner and at the end of each year one-half of the amounts received as director's fees in such year was credited to Edna Mills and charged against petitioner. Appropriate credits and charges were also made from time to time to equalize the amounts of salary checks received by petitioner and Edna Mills, respectively, and to equalize the deductions therefrom for withholding taxes and the State of California unemployment insurance tax. The Federal Old Age Benefit tax was treated as chargeable solely to petitioner, and Edna Mills was credited for the deductions from her checks on account of Federal Old Age Benefit tax. The amounts of federal withholding and victory tax withheld from the salary checks received by Edna Mills, less adjustments made to equalize such taxes with those withheld from checks received by petitioner, were taken as credits by Edna Mills against her federal income tax liability.

9. The total compensation for the personal services rendered by petitioner for the years 1943 to 1945, inclusive, was as follows:

Salary, Rayonier, Incorporated, 1943, $50,623.92; 1944, $33,957.32; 1945, $30,738.00.

Director's fees, 1943, $240.00; 1944, $240.00; 1945, $220.00.

Total, 1943, $50,863.92; 1944, $34,197.32; 1945, $30,958.00.

The amounts of the salary payments made by Rayonier, Incorporated, and the director's fees paid to petitioner and to Edna Mills for each of the years 1943 to 1945, inclusive, the deductions with respect to the salary payments made by Rayonier, Incorporated, and the amounts debited and credited on the books of account of petitioner and Edna Mills to equalize salary payments and deductions therefrom for each of the years 1943 to 1945, inclusive, were as set forth in Exhibit A attached hereto and made a part hereof.

In arriving at the deficiencies involved in these proceedings, respondent determined that the petitioner made taxable gifts to Edna Mills in the amounts of one-half of the total compensation for personal services rendered by petitioner for each of said years. The Commissioner erroneously determined that one-half of said total compensation for the years 1943 and 1944 were the amounts of $25,366.44 and $17,033.14, respectively, instead of the amounts of $25,431.96 for 1943 and $17,098.66 for 1944.

10. Petitioner and Edna Mills filed separate federal income tax returns for each of the calendar years 1939 to 1945, inclusive. Petitioner included in his separate returns one-half of the salary and other compensation for personal services rendered by him, and Edna Mills included in her separate returns one-half of said salary and other compensation.

11. For the year 1943 the total amount of petitioner's net gifts for preceding taxable years was $142,407.11. For the year 1944 the total amount of petitioner's net gifts for preceding taxable years was $142,407.11, plus the amount of any taxable gifts that may be determined herein for the year 1943. For the year 1945 the total amount of petitioner's net gifts for preceding taxable years was $142,407.11, plus the amount of any taxable gifts that may be determined herein for the years 1943 and 1944. In arriving at petitioner's net gifts for preceding taxable years, the respondent has not treated the receipt by Edna Mills of any of the compensation for personal services of petitioner during the years 1939 to 1942, inclusive, as taxable gifts by petitioner.

Dated: San Francisco, California, May ...., 1947.

/s/ SIGVALD NIELSON,
/s/ HARRY R. HORROW,
/s/ DOUGLAS ERSKINE,
Counsel for Petitioner.

/s/ J. P. WENCHEL,
Chief Counsel, Bureau of Internal Revenue, Counsel for Respondent.

[Title of Tax Court and Cause.]

Docket Nos. 12316, 13032

REPORT OF TAX COURT

Promulgated March 28, 1949

Gift Tax.—Taxpayer and his wife were residents of California, and each month he paid to his wife one-half of his salary as received. Held, that under the community property laws of California the title to one-half of his salary as earned vested in his wife and payments of same to her were not subject to a gift tax within the purview of section 1000 (d), Internal Revenue Code. [Sec. 453, Rev. Act 1942] Sec. 86.2, Regulations 108 in part disapproved.

Harry R. Horrow, Esq., for the petitioner.

Chas. W. Nyquist, Esq., for the respondent.

These proceedings were consolidated. Respondent determined deficiencies in petitioner's Federal gift tax for the years 1943, 1944 and 1945, as follows:

1943	$5,032.45
1944	3,157.46
1945	2,807.77

The question involved is whether or not petitioner made gifts to his wife during the taxable years which are taxable within the purview of section 1000(d), Internal Revenue Code.

Findings of Fact

The stipulation of facts filed herein we adopt, and from which, together with oral testimony and exhibits introduced at the hearing, we find that:

of them would own and hold the one-half of said community property so allotted and delivered to each as his or her separate property.

The agreement did not include or relate to the future salary and earnings of the petitioner. Petitioner for many years prior thereto had each month voluntarily and without any obligation so to do paid to his wife one-half of his salary, and it was understood that he would continue so to do, but there was no agreement or binding obligation that he would do so, and the payments of salary as received by him from his employer continued to be the community property of himself and his wife.

Their community property on December 31, 1938, consisted of various stocks and bonds in the names of petitioner or petitioner and Edna Mills, jointly, and pursuant to the agreement these were equally

Petitioner is an individual residing in San Francisco, California, and seasonably filed his gift tax returns for the years 1943, 1944 and 1945 with the collector of internal revenue for the first district of California.

Petitioner is married and he and his wife, Edna Mills, are now, and have at all times since July 29, 1927, been husband and wife and residents of California.

On or about January 1, 1939, petitioner and his wife entered into an oral agreement by which they divided equally between them all community property owned by them on December 31, 1938, with the understanding and agreement that thereafter each

divided, one-half of same being transferred to Edna Mills and thereafter held in her name and one-half in the name of petitioner. Separate books of account were then set up and thereafter kept for petitioner and his wife. In his appears this entry, dated January 1, 1939:

> To transfer to Edna Mills her one-half interest in the community property at December 31, 1938,

followed by a list of the securities so transferred to Edna Mills, which were carried on petitioner's books of account at the amount of $270,973.13. At all times thereafter separate bank accounts were kept for petitioner and his wife and the separate income of each was deposited to the credit of each in their respective bank accounts.

Continuously since January 1, 1939, and prior thereto one-half of petitioner's salary as received by him has been delivered by him to his wife. During said time petitioner has been an officer and director in one corporation and a director in another. His salary as such officer was payable in equal semi-monthly installments after deductions were made therefrom for Federal old age benefit tax imposed on employees, the State of California unemployment insurance tax, the Federal withholding tax on wages, group insurance premiums, and for the purchase of U. S. Savings Bonds, Series E. Continuously since January 1, 1939, checks covering these semi-monthly payments of salary, after these

deductions, were delivered and made payable to petitioner. One of the checks for each month was deposited by petitioner's secretary in his separate bank account and the other was indorsed by petitioner's secretary on his behalf to the order of his wife and deposited by his secretary in his wife's separate bank account.

During 1943, 1944 and 1945, the deduction from salary payments to petitioner with which to purchase U. S. Savings Bonds totaled $4,800 in each year, of which $2,400 was expended to purchase such bonds in petitioner's name and $2,400 to purchase such bonds in his wife's name. Checks for director's fees were deposited in petitioner's separate bank account and at the end of each year adjustment was made so that one-half of same was credited to his wife. The Federal old age benefit tax was treated as chargeable solely to petitioner, and his wife was given credit for such deductions.

The total compensation received for personal services rendered by petitioner for the years 1943 to 1945, inclusive, was as follows:

Salary, Rayonier, Incorporated, 1943, $50,623.92; 1944, $33,957.32; 1945, $30,738.00.

Director's fees, 1943, $240.00; 1944, $240.00; 1945, 220.00.

Total, 1943, $50,863.92; 1944, $34,197.32; 1945, $30,958.00.

In arriving at the deficiencies involved in these proceedings, respondent determined that the petitioner made taxable gifts to Edna Mills in the amounts of one-half of the total compensation re-

ceived for personal services rendered by petitioner for each of said years. The Commissioner admits that he erroneously determined that one-half of said total compensation for the years 1943 and 1944 were the amounts of $25,366.44 and $17,033.14, respectively, instead of the amounts of $25,431.96 for 1943 and $17,098.66 for 1944.

Petitioner and Edna Mills filed separate Federal income tax returns for each of the calendar years 1939 to 1945, inclusive. Petitioner included in his separate income tax returns one-half of the salary and other compensation for personal services rendered by him, and Edna Mills included in her separate income tax returns one-half of said salary and other compensation.

For the years 1943 the total amount of petitioner's net gifts for preceding taxable years was $142,407.11; for 1944 and 1945 the same amount, plus the amount of any taxable gifts that may be determined herein.

In arriving at petitioner's net gifts for preceding taxable years, the respondent did not treat the receipt by Edna Mills (his wife) of any of the compensation for personal services of petitioner during the years 1939 to 1942, inclusive, as taxable gifts by petitioner, although petitioner in each of said years did deliver to his wife one-half of his salary and all compensation received by him. Neither did the respondent contend that the compensation payments made by petitioner to his wife from 1939 to 1942, inclusive, constituted taxable gifts, and petitioner filed no gift tax returns therefor.

To prevent imposition of penalty, petitioner filed gift tax returns for each of the years 1943, 1944 and 1945, setting out the facts and the amounts contributed to his wife, but claiming therein that there was no gift tax due.

Respondent's notice of deficiency to petitioner for the calendar year 1943 contained this statement:

(a) It has been determined that one-half of your salary, or $25,366.44 (½ of $50,732.88) which was converted to separate property of your wife during the calendar year 1943, constitutes a taxable gift within the meaning of Article 86.2(c) of Regulations 108.

Respondent's deficiency notices to petitioner for 1944 and 1945 each contained a statement identical with above, except in the one for 1944 one-half of petitioner's salary was alleged to be $17,033.14, and in the one for 1945 one-half of petitioner's salary was given as $15,479.

Opinion

Johnson, Judge:

Did the delivery by petitioner to his wife, during the years 1943, 1944 and 1945, of one-half of his salary and personal earnings as the same were paid to him constitute a taxable gift within the purview of section 1000(d), Internal Revenue Code?[1] This

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[1][Sec. 1000(d)].

(d) Community Property—All gifts of property held as community property under the law of any State, Territory or possession of the United States, or any foreign country, shall be considered to be

was section 453 of the Revenue Act of 1942 and was applicable to gifts made in the calendar year 1943 and succeeding years. The Revenue Act of 1948 repealed the section by limiting its applicability to gifts made before the enactment of the Revenue Act of 1948. [April 2, 1948]

The substantial portion of section 1000(d) as here pertinent provides that:

All gifts of property held as community property under the law of any state * * * shall be considered to be the gifts of the husband * * *.

Respondent impliedly concedes, and correctly so, that unless the transactions here involved are covered by section 1000(d), there is no gift tax liability. He asserted no gift tax liability on the transfer by petitioner in 1939 of one-half of the entire community estate to his wife, nor on the transfer to her of one-half of his personal earnings in each of the years from 1939 to 1942, inclusive, for the obvious reason that under the community property laws of California since 1927, all of the property so delivered by the petitioner to his wife already be-

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the gifts of the husband except that gifts of such property as may be shown to have been received as compensation for personal services actually rendered by the wife or derived originally from such compensation or from separate property of the wife shall be considered to be gifts of the wife. This subsection shall be applicable only to gifts made after the calendar year 1942 and on or before the date of the enactment of the Revenue Act of 1948. [Note: The underscored sentence was added by the Revenue Act of April 2, 1948.]

longed to her and was her property in which she had a "present vested interest." United States v. Malcolm, 282 U.S. 792; Commissioner v. Harmon, 323 U.S. 44; Paul C. Cavanagh, 42 B.T.A. 1037. The same is true of the payments in question. The salary and compensation of petitioner was community property, and the one-half of same which he delivered to his wife was her property, not his.

No case is cited and none has come to our attention where a Federal gift tax has been imposed or sought to be imposed upon the husband in California for transferring to his wife one-half of his salary or other community property belonging to them, provided the transaction occurred, or related to property acquired, subsequent to July 29, 1927, when the California law was amended to make the wife's interest in the community property "present, existing and equal," (see section 161(a) Civil Code of California) rather than a "mere expectancy" as the prior law had been construed to mean.

If similar payments in the same manner made by petitioner to his wife prior to 1943 were not subject to a gift tax, evidently because the sums so paid already belonged to her and could not be the subject of a gift, why were the payments in controversy not in the same category?

The respondent contends that the enactment of section 1000(d) caused these payments after 1942 to become taxable gifts. We do not think so. They were not gifts and hence do not come within the purview of section 1000(d). This section is predi-

cated upon the existence of a gift. Under its own terms it specifically relates to and is based upon "all gifts of property held as community property." [Underscoring ours.] It applies only when there is a gift of property. The section nowhere defines nor attempts to change or impose any new meaning of the word "gift." What constituted a gift before its enactment remained the same after it became law. The only change that it made in the Federal gift tax law was to decree that when a "gift of community property" was made it "shall be considered to be the gift of the husband." In other words, the husband would be deemed the sole donor and the gift tax upon the transaction would be taxable to him alone, rather than divisible between him and his wife. We think it clear that in the absence of a gift section 1000(d) can not be invoked.

But respondent says the section is here applicable because the language of a regulation issued by the Treasury Department fits these transactions, and in his letter of deficiency cites and relies upon Treasury Regulation 108, section 86.2, wherein the Treasury interprets section 1000(d) to apply:

* * * to a division of community property between husband and wife into the separate property of each, and to a transfer by the husband and wife of any part of such community property into the separate property either of the husband or of the wife. * * *

If this were the language of the Code, a different question would be here presented, but we agree with

petitioner that the regulation as here applied can not be sustained as valid, it being an unwarranted expansion and enlargement of the meaning of section 1000(d). The language and effect of the regulation, as construed by respondent, is to make any division of community property, equal or otherwise, between husband and wife taxable as a gift. Since the section in question is restricted to gifts of property, the regulation can not enlarge its meaning so as to apply to a transaction other than a gift. The language of the regulation or its import making taxable a division of community property between husband and wife is not contained in the section or elsewhere in the Internal Revenue Code. Congress may have the power to make such divisions of community property taxable, but it has not done so, and the Treasury Department cannot legislate such a provision into the law under the guise of a regulation.

An equal division of community property between husband and wife under California law can not be construed to be a gift. A gift is defined as being "the act by which the owner of a thing voluntarily transfers the title and possession of the same from himself to another without consideration." 38 C. J. Secundum 781, and authorities there cited. It can not be said here that petitioner was "the owner" of the moiety of his salary delivered to his wife for under the law of California she was its owner, neither can it be said that he "transferred the title" to same since title thereto was already vested in her.

Gillis v. Welch, (C.C.A., 9th Cir.) 80 Fed. (2d) 165 covered transaction in California occurring prior to 1927 wherein the husband was held liable for a gift tax for transferring to his wife certain community property, since under the law then existing there the husband was the owner of all of the community property and the wife had a "mere expectancy" therein and hence the transfer of any of the community property to her constituted a gift. The Court, in passing upon the issue, said:

The interest of the wife in the property which was the subject of the gift must be determined, for it is clear that the husband could not give to the wife more than that which he had. * * * [Underscoring ours.]

There the husband owned it all and a transfer of any part was a gift. Here the wife already owned the one-half in question, and the husband could not give to her that which he did not own.

We are not impressed with respondent's contention that because of the husband's management and control of the community property under California law his relinquishment of such control by delivery to his wife clothed the transaction with the attributes of a gift. If A and B are equal owners of a firm's business, the fact that A is the managing partner would not make his payments to B of B's interest therein a gift. As was said in Bank of America v. Collector of Internal Revenue, 33 Fed. Supp. 183:

* * * The management and control, which the

husband has under the law of California, does not defeat the character of the wife's interest as that of a half owner. California Civil Code, Secs. 172, 172a.

To the same effect, in Paul Cavanagh, 42 B.T.A. 1037, we declared:

The fact that under the California law the husband has a broad power of control does not detract from the wife's interest. This power is conferred upon him merely as the agent of the community and does not make him the owner of all the community property and income, nor negative the wife's present interest there as equal coowner.

In James A. Hogle, 7 T.C. 986, affirmed (C.C.A., 10th Cir.) 165 Fed. (2d) 352, [the Gov't has indicated that it will not apply for certiorari] we held that the taxpayer was not subject to a gift tax on the net gains and profits from marginal trading in securities realized by two trusts created by him, even though the trading account was operated under the taxpayer's direction, for the reason that the legal title to the amounts in question never vested in him but in the trust from the moment they arose. We said "that legal title to the amounts in question was never in the petitioner and was never transferred by him to the trusts." Such is true here. Petitioner here transferred possession, but not title. The title to the amounts in question was always vested in petitioner's wife from the very moment they were earned, not by the grace of petitioner, but by virtue of the law of California.

Respondent's imposition of a gift tax herein is reversed.

Reviewed by the Court.

Decision will be entered for the petitioner.

Opper, J., concurs only in the result.

[T.C.U.S. Seal]

Served March 29, 1949.

The Tax Court of the United States, Washington

Docket No. 12316

EDWARD M. MILLS,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

DECISION

Pursuant to the determination of the Court as set forth in its Findings of Fact and Opinion, promulgated March 28, 1949, it is

Ordered and Decided: That there are no deficiencies in gift tax for the years 1943 and 1944.

Enter: Mar. 28, 1949.

Served Mar. 29, 1949.

[Seal] /s/ LUTHER A. JOHNSON,

Judge.

The Tax Court of the United States, Washington

Docket No. 13032

EDWARD M. MILLS,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

DECISION

Pursuant to the determination of the Court as set forth in its Findings of Fact and Opinion, promulgated March 28, 1949, it is

Ordered and Decided: That there is no deficiency in gift tax for the year 1945.

Enter: Mar. 28, 1949.

Served Mar. 29, 1949.

[Seal] /s/ LUTHER A. JOHNSON,
Judge.

In the United States Court of Appeals
for the Ninth Circuit

T. C. Docket Nos. 12316, 13032

COMMISSIONER OF INTERNAL REVENUE,
Petitioner on Review,

vs.

EDWARD M. MILLS,
Respondent on Review.

PETITION FOR REVIEW

To the Honorable Judges of the United States Court of Appeals for the Ninth Circuit:

The Commissioner of Internal Revenue hereby petitions the United States Court of Appeals for the Ninth Circuit to review the decisions entered by The Tax Court of the United States on March 28, 1949 that there are no deficiencies in gift tax for the years 1943, 1944 and 1945 in respect of the gift tax liability of Edward M. Mills, the above-named respondent on review. This petition for review is filed pursuant to the provisions of Sections 1141 and 1142 of the Internal Revenue Code.

The respondent on review, Edward M. Mills, is a resident of San Francisco, California, and filed his gift tax returns for the years 1943, 1944 and 1945 with the Collector of Internal Revenue for the First District of California, whose office is in San Francisco and within the jurisdiction of the United

States Court of Appeals for the Ninth Circuit, wherein this review is sought.

Nature of Controversy

The issue presented to and passed upon by the Tax Court and which was decided contrary to the Commissioner's determination is whether the payment by the taxpayer to his wife, as her separate property, of one-half of his salary as received during the taxable years constituted a "division of community property between husband and wife into the separate property of each" within the meaning of Section 86.2(c) of Regulations 108, which regulations were established in construing Section 1000(d) of the Internal Revenue Code. The Tax Court held, contrary to the Commissioner's determination, that the payments so made to respondent's wife were not subject to gift tax within the purview of Section 1000(d) of the Internal Revenue Code and held, further, that Section 86.2 of Regulations 108 providing for a gift tax in respect of a division of community between husband and wife into the separate property of each is invalid. The deficiencies in tax determined by the Commissioner in the respective amounts of $5,032.45, $3,157.46 and $2,807.77 as the result of his inclusion in respondent's net gifts of the value of one-half of his salary received during each of the taxable years were thus disapproved by the Tax Court and decisions of no deficiency in tax for the years involved were sub-

stituted for the deficiencies determined by the Commissioner.

/s/ THERON L. CAUDLE,
Assistant Attorney General.
/s/ CHARLES OLIPHANT,
Chief Counsel,
Bureau of Internal Revenue, Counsel for Petitioner on Review.

Received and filed June 21, 1949. T.C.U.S.

[Title of Court of Appeals and Cause.]

T. C. Docket Nos. 12316, 13032

NOTICE OF FILING PETITION FOR REVIEW

To: Mr. Edward M. Mills, 343 Sansome Street, San Francisco 4, California.

You are hereby notified that the Commissioner of Internal Revenue did, on the 21st day of June, 1949, file with the Clerk of The Tax Court of the United States, at Washington, D. C., a petition for review by the United States Court of Appeals for the Ninth Circuit of the decisions of the Tax Court heretofore rendered in the above-entitled cause. A copy of the petition for review as filed is hereto attached and served upon you.

Dated this 21st day of June, 1949.

/s/ CHARLES OLIPHANT,
Chief Counsel,
Bureau of Internal Revenue, Counsel for Petitioner on Review.

Personal service of the above and foregoing notice, together with a copy of the petition for review, is hereby acknowledged this 28th day of June, 1949.

/s/ EDWARD M. MILLS,
Respondent on Review.

Received and filed June 30, 1949. T.C.U.S.

[Title of Court of Appeals and Cause.]

T. C. Docket Nos. 12316, 13032

NOTICE OF FILING PETITION FOR REVIEW

To: Harry R. Horrow, Esquire, Standard Oil Building, 225 Bush Street, San Francisco 4, California.

You are hereby notified that the Commissioner of Internal Revenue did, on the 21st day of June, 1949, file with the Clerk of The Tax Court of the United States, at Washington, D. C., a petition for review by the United States Court of Appeals for the Ninth Circuit of the decisions of the Tax Court heretofore rendered in the above-entitled cause. A copy of the petition for review as filed is hereto attached and served upon you.

Dated this 21st day of June, 1949.

/s/ CHARLES OLIPHANT,
Chief Counsel,
Bureau of Internal Revenue, Counsel for Petitioner on Review.

Personal service of the above and foregoing notice, together with a copy of the petition for review, is hereby acknowledged this 27th day of June, 1949.

/s/ HARRY R. HORROW,
Counsel for Respondent on Review.

Received and filed June 30, 1949. T.C.U.S.

[Title of Court of Appeals and Cause.]

T. C. Docket Nos. 12316, 13032

STATEMENT OF POINTS

Comes Now the Commissioner of Internal Revenue, petitioner on review in the above-entitled cause, by and through his attorneys, Theron L. Caudle, Assistant Attorney General, and Charles Oliphant, Chief Counsel, Bureau of Internal Revenue, and hereby states that he intends to rely upon the following points in this proceeding:

The Tax Court of the United States erred:

1. In entering its decisions that there are no deficiencies in gift taxes for the years 1943, 1944 and 1945.

2. In failing and refusing to sustain the deficiencies in tax determined by the Commissioner.

3. In holding and deciding that the payments made by the taxpayer to his wife as her separate property of 50% of the earnings of the taxpayer during the years 1943, 1944 and 1945 were not subject to gift tax within the purview of Section 1000 (d) of the Internal Revenue Code and Section 86.2 of Treasury Regulations 108.

4. In failing and refusing to hold and decide that the payments made by the taxpayer to his wife as her separate property of 50% of the earnings of the taxpayer during the years 1943, 1944 and 1945 constituted gifts from the taxpayer to his wife and as such were subject to gift tax within the purview of Section 1000(d) of the Internal Revenue Code and Section 86.2 of Treasury Regulations 108.

5. In holding and deciding that Section 86.2 of Treasury Regulations 108 is invalid as being an unwarranted expansion and enlargement of the meaning of Section 1000(d) of the Internal Revenue Code.

6. In that its opinion and decisions are not supported by but are contrary to its findings of fact.

7. In that its opinion and decisions are contrary to law and the Commissioner's regulations.

/s/ THERON L. CAUDLE,
Assistant Attorney General.
/s/ CHARLES OLIPHANT,
Chief Counsel,
Bureau of Internal Revenue, Counsel for Petitioner on Review.

Statement of Service:

A copy of this Statement of Points was mailed to Harry R. Horrow, Esquire, 225 Bush Street, San Francisco 4, California, attorney for respondent on review, on July 7, 1949.

/s/ CHAS. E. LOWERY,
Special Attorney,
Bureau of Internal Revenue.

Received and filed July 7, 1949. T.C.U.S.

[Title of Court of Appeals and Cause.]

T. C. Docket Nos. 12316, 13032

RECORD ON REVIEW

To the Clerk of The Tax Court of the United States:

Pursuant to the provisions of Rule 75(o) of the Federal Rules of Civil Procedure adopted by the United States Court of Appeals for the Ninth Circuit, you are hereby notified that the petitioner on review will not exclude or omit any part of the record in this proceeding.

/s/ THERON L. CAUDLE,
Assistant Attorney General.
/s/ CHARLES OLIPHANT,
Chief Counsel,
Bureau of Internal Revenue, Counsel for Petitioner on Review.

Statement of Service:

A copy of this "Record on Review" was mailed to Harry R. Horrow, Esquire, 225 Bush Street, San Francisco 4, California, attorney for respondent on review, on July 7, 1949.

/s/ CHAS. E. LOWERY,
Special Attorney,
Bureau of Internal Revenue.

Received and filed July 7, 1949. T.C.U.S.

The Tax Court of the United States, Washington

Docket Nos. 12316 - 13032

COMMISSIONER OF INTERNAL REVENUE,
Petitioner on appeal,

vs.

EDWARD M. MILLS,
Respondent on appeal.

CERTIFICATE

I, Victor S. Mersch, Clerk of The Tax Court of the United States do hereby certify that the foregoing documents 1 to 30, inclusive, constitute and are all of the original papers and proceedings on file in my office as the original and complete records in the proceedings before The Tax Court of the United States entitled "Edward M. Mills, Petitioner v. Commissioner of Internal Revenue, Re-

spondent," Docket Nos. 12316 and 13032 and in which the respondent in the Tax Court proceedings has initiated appeals as above numbered and entitled, together with true copies of the docket entries in said Tax Court proceedings, as the same appear in the official docket books in my office.

In testimony whereof, I hereunto set my hand and affix the seal of The Tax Court of the United States, at Washington, in the District of Columbia, this 20th day of July, 1949.

[Seal] /s/ VICTOR S. MERSCH,
Clerk.

[Endorsed]: No. 12305. United States Court of Appeals for the Ninth Circuit. Commissioner of Internal Revenue, Petitioner, vs. Edward M. Mills, Respondent. Transcript of the Record. Upon Petition to Review a Decision of The Tax Court of the United States.

Filed July 27, 1949.

/s/ PAUL P. O'BRIEN,
Clerk of the United States Court of Appeals for the Ninth Circuit.

In the United States Court of Appeals
for the Ninth Circuit

Tax Court Docket Nos. 12316 and 13032

COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

vs.

EDWARD M. MILLS,
Respondent.

DESIGNATION OF PORTIONS OF RECORD TO BE PRINTED

The Commissioner of Internal Revenue, petitioner in the above entitled proceedings, hereby designates the following portions of record on review on file in this Court which are to be printed:

1. (No. 1) Docket entries in Docket No. 12316.
2. (No. 1) Docket entries in Docket No. 13032.
3. (No. 2) Petition of Edward M. Mills, Petitioner, filed in the Tax Court of the United States on October 16, 1946, in Docket No. 12316.
4. (No. 4) Answer of the Commissioner of Internal Revenue filed in the Tax Court November 27, 1946, in Docket No. 12316.
5. (No. 8) Petition of Edward M. Mills filed in the Tax Court on February 11, 1947, in Docket No. 13032.
6. (No. 10) Answer of the Commissioner filed in the Tax Court March 19, 1947, in Docket No. 13032.

7. (No. 13) Joint motion for consolidation of proceedings and for placing on hearing calendar together with orders stamped thereon to the effect that the motion was granted by the Tax Court May 7, 1947.

8. (No. 15) Transcript of proceedings had before the Tax Court at San Francisco, California, on May 26, 1947, in Docket Nos. 12316 and 13032.

9. (No. 16) Stipulation of facts in Docket Nos. 12316 and 13032 filed at the hearing before the Tax Court on May 26, 1947.

10. (No. 17) Petitioner's Exhibit No. 1, being gift tax return for the calendar year 1943 of Edward M. Mills. Omit all stampings as also the affidavit of person filing return and in the place thereof state merely that return was duly verified. Also omit Schedule B from the second page and the verification of the affidavit of Edward M. Mills attached to the return and in the place thereof make a statement to the effect that it is duly verified.

11. (No. 17) Petitioner's Exhibit No. 2, gift tax return of E. M. Mills for the calendar year 1944. Omit all stamping as also the affidavit of person filing return and in the place thereof indicate that the return was duly verified. On the second page omit Schedule B.

12. (No. 17) Petitioner's Exhibit No. 3, gift tax return of E. M. Mills for the calendar year 1945. Omit all stamps and affidavit of person filing return, stating in the place thereof that the same was duly verified. On the second page omit Schedule B.

13. (No. 17) Petitioner's Exhibit No. 4, information return of Edward M. Mills of gifts for the calendar year 1943. Omit all stampings and the instructions on the second page indicating that these instructions are omitted.

14. (No. 17) Petitioner's Exhibit No. 5, information return of Edward M. Mills of gifts for the calendar year 1944. Omit stamps and instructions on second page indicating that these are omitted.

15. (No. 17) Petitioner's Exhibit No. 6, information return of E. M. Mills for the calendar year 1945. Omit stamps and instructions on the second page indicating that the instructions have been omitted.

16. (No. 25) Report of the Tax Court.

17. (No. 26) Decision of the Tax Court in Docket No. 12316 entered March 28, 1949.

18. (No. 27) Decision of the Tax Court in Docket No. 13032 entered March 28, 1949.

19. (No. 28) Petition for review filed in the United States Court of Appeals for the Ninth Circuit by the Commissioner of Internal Revenue in Tax Court Dockets 12316 and 13032 together with the filing date (July 27, 1929), and append thereto a statement to the effect that due notice of the filing of the petition (No. 28) was given to Harry R. Horrow, Esq., Standard Oil Building, 225 Bush Street, San Francisco 4, California, counsel for respondent on review by Charles Oliphant, Chief Counsel of the Bureau of Internal Revenue, counsel for petitioner on review on June 21, 1949, personal

service of such notice being accepted by Harry R. Horrow, Esq., counsel for respondent on review on June 27, 1949.

20. (No. 29) Statement of points.

21. (No. 30) Notice re contents of record on review.

22. Certificate of the Clerk of the Tax Court. August 2, 1949.

/s/ THERON L. CAUDLE,
Assistant Attorney General.

Docketed

[Endorsed]: Filed Aug. 8, 1949. U.S.C.A.

No. 12305

In the United States Court of Appeals for the Ninth Circuit

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

EDWARD M. MILLS, RESPONDENT

ON PETITION FOR REVIEW OF THE DECISIONS OF THE TAX COURT OF THE UNITED STATES

BRIEF FOR THE PETITIONER

THERON LAMAR CAUDLE,
Assistant Attorney General.

ELLIS N. SLACK,
HELEN GOODNER,
CARLTON FOX,
Special Assistants to the Attorney General.

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In the United States Court of Appeals
for the Ninth Circuit

No. 12305

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

EDWARD M. MILLS, RESPONDENT

ON PETITION FOR REVIEW OF THE DECISIONS OF THE TAX COURT OF THE UNITED STATES

BRIEF FOR THE PETITIONER

OPINION BELOW

The only previous opinion is that of the Tax Court promulgated March 28, 1949 (R. 61-73), which is reported in 12 T. C. 468.

JURISDICTION

The petition for review (R. 75-77) involves deficiencies in federal gift taxes determined by the Commissioner of Internal Revenue against the taxpayer, Edward M. Mills, for the gift tax year 1943 in the amount of $5,032.45, for the gift tax year 1944 in the amount of $3,157.46, and for the gift tax year 1945 in the amount of $2,807.77. On August 9, 1946, the Commissioner mailed the taxpayer a notice of deficiency in gift taxes for the gift tax years 1943 and 1944 in the aggregate amount of $8,189.91. (R. 9-13.) Within 90 days thereafter, and on October 16, 1946, the taxpayer filed a petition with the Tax Court of the

United States for a redetermination of such deficiency under the provisions of Section 1012(a)(1) of the Internal Revenue Code. (R. 5-13.) On November 20, 1946, the Commissioner mailed to the taxpayer, a notice of deficiency in gift tax for the gift tax year 1945 in the amount of $2,807.77. (R. 18-20.) Within 90 days thereafter, and on February 11, 1947, the taxpayer filed a petition with the Tax Court of the United States for a redetermination of such deficiency, also under the provisions of Sections 1012(a)(1) of the Code. (R. 15-20.) The two proceedings were consolidated for hearing before the Tax Court. (R. 22-20.) The decision of the Tax Court that there are no deficiencies in gift tax for the years 1943 and 1944 was entered March 28, 1949 (R. 73), and its decision that there is no deficiency in gift tax for the year 1945 was entered on March 28, 1949 (R. 74). The proceeding is brought to this Court by a petition for review filed June 21, 1949 (R. 75-76), under the provisions of Section 1141(a) of the Internal Revenue Code, as amended by Section 36 of the Act of June 25, 1948.

QUESTIONS PRESENTED

1. Whether an agreement entered into between the taxpayer and his wife on January 1, 1939, in so far as it contemplated a division of the taxpayer's future earnings between him and his wife into the separate property of each, precluded the imposition of the federal gift tax upon the taxpayer in each of the gift tax years 1943, 1944 and 1945 in respect of the moiety of such earnings which she physically received as her separate property in each of those years upon the actual division thereof.

2. If not, then whether the actual division of such earnings in each of those years between the taxpayer and his wife into the separate property of each constitutes a gift by him to her of a moiety thereof in each

of those years within the meaning of Sections 1000(a) and (d) and 1002 of the Internal Revenue Code.

STATUTE AND REGULATIONS INVOLVED

The statute and Regulations involved are set out in the Appendix, *infra*.

STATEMENT

The Tax Court adopted the stipulation of the parties from which, together with oral testimony and exhibits introduced at the hearing, it found the facts as follows:

The taxpayer is an individual residing in San Francisco, California, and seasonably filed his gift tax returns for the years 1943, 1944 and 1945 with the Collector of Internal Revenue for the First District of California. (R. 62.)

The taxpayer is married and he and his wife, Edna Mills, are now, and have at all times since July 29, 1927, been husband and wife and residents of California. (R. 62.)

On or about January 1, 1939, taxpayer and his wife entered into an oral agreement by which they divided equally between them all community property owned by them on December 31, 1938, with the understanding and agreement that thereafter each of them would own and hold the one-half of the community property so allotted and delivered to each as his or her separate property. (R. 62.)

The agreement did not include or relate to the future salary and earnings of the taxpayer. The taxpayer for many years prior thereto had each month voluntarily and without any obligation so to do paid to his wife one-half of his salary, and it was understood that he would continue so to do, but there was no agreement or binding obligation that he would do so, and the payments of salary as received by him from his employer continued to be the community property of himself and his wife. (R. 62.)

Their community property on December 31, 1938, consisted of various stocks and bonds in the names of the taxpayer or the taxpayer and Edna Mills, jointly, and pursuant to the agreement these were equally divided, one-half of them being transferred to Edna Mills and thereafter held in her name and one-half in the name of the taxpayer. Separate books of account were then set up and thereafter kept for the taxpayer and his wife. In his appears this entry, dated January 1, 1939:

> To transfer to Edna Mills her one-half interest in the community property at December 31, 1938,

followed by a list of the securities so transferred to Edna Mills, which were carried on the taxpayer's books of account at the amount of $270,973.13. At all times thereafter separate bank accounts were kept for the taxpayer and his wife and the separate income of each was deposited to the credit of each in their respective bank accounts. (R. 62-63.)

Continuously since January 1, 1939, and prior thereto one-half of the taxpayer's salary as received by him has been delivered by him to his wife. During that time the taxpayer has been an officer and director in one corporation and a director in another. His salary as such officer was payable in equal semi-monthly installments after deductions were made therefrom for federal old age benefit tax imposed on employees, the State of California unemployment insurance tax, the federal withholding tax on wages, group insurance premiums, and for the purchase of U. S. Savings Bonds, Series E. Continuously since January 1, 1939, checks covering these semi-monthly payments of salary, after these deductions, were delivered and made payable to the taxpayer. One of the checks for each month was deposited by the tax-

payer's secretary in his separate bank account and the other was indorsed by the taxpayer's secretary on his behalf to the order of his wife and deposited by his secretary in his wife's separate bank account. (R. 63-64.)

During 1943, 1944 and 1945, the deduction from salary payments to the taxpayer with which to purchase U. S. Savings Bonds totaled $4,800 in each year, of which $2,400 was expended to purchase such bonds in the taxpayer's name and $2,400 to purchase such bonds in his wife's name. Checks for director's fees were deposited in the taxpayer's separate bank account and at the end of each year adjustment was made so that one-half thereof was credited to his wife. The federal old age benefit tax was treated as chargeable solely to the taxpayer, and his wife was given credit for such deductions. (R. 64.)

The total compensation received for personal services rendered by the taxpayer for the years 1943 to 1945, inclusive, was as follows (R. 64):

Salary, Rayonier, Incorporated, 1943, $50,623.92; 1944, $33,957.32; 1945, $30,738.

Director's fees, 1943, $240; 1944, $240; 1945, $220.

Total, 1943, $50,863.92; 1944, $34,197.32; 1945, $30,958.00.

In arriving at the deficiencies involved in these proceedings, the Commissioner determined that the taxpayer made taxable gifts to Edna Mills in the amounts of one-half of the total compensation received for personal services rendered by the taxpayer for each of the years. The Commissioner admits that he erroneously determined that one-half of the total compensation for the years 1943 and 1944 were the amounts of $25,366.44 and $17,033.14, respectively, instead of the amounts of $25,431.96 for 1943 and $17,098.66 for 1944. (R. 64-65.)

The taxpayer and Edna Mills filed separate federal income tax returns for each of the calendar years 1939 to 1945, inclusive. The taxpayer included in his separate income tax returns one-half of the salary and other compensation for personal services rendered by him, and Edna Mills included in her separate income tax returns one-half of the salary and other compensation. (R. 65.)

For the years 1943 the total amount of the taxpayer's net gifts for preceding taxable years was $142,407.11; for 1944 and 1945 the same amount, plus the amount of any taxable gifts that may be determined herein. (R. 65.)

In arriving at the taxpayer's net gifts for preceding taxable years, the Commissioner did not treat the receipt by Edna Mills (taxpayer's wife) of any of the compensation for personal services of the taxpayer during the years 1939 to 1942, inclusive, as taxable gifts by taxpayer, although taxpayer in each of those years did deliver to his wife one-half of his salary and all compensation received by him. Neither did the Commissioner contend that the compensation payments made by taxpayer to his wife from 1939 to 1942, inclusive, constituted taxable gifts, and taxpayer filed no gift tax returns therefor. (R. 65.)

To prevent imposition of penalty, taxpayer filed gift tax returns for each of the years 1943, 1944 and 1945, setting out the facts and the amounts contributed to his wife, but claiming therein that there was no gift tax due. (R. 66.)

The Commissioner's notice of deficiency to taxpayer for the calendar year 1943 contained this statement (R. 66.):

> (a) It has been determined that one-half of your salary, or $25,366.44 (½ of $50,732.88) which was converted to separate property of your wife during

the calendar year 1943, constitutes a taxable gift within the meaning of Article 86.2(c) of Regulations 108.

The Commissioner's deficiency notices to the taxpayer for 1944 and 1945 each contained a statement identical with the above, except in the one for 1944 one-half of the taxpayer's salary was alleged to be $17,033.14, and in the one for 1945 one-half of the taxpayer's salary was given as $15,479. (R. 66.)

The Tax Court held that, though the taxpayer's earnings constituted community property in each of the gift tax years in which they were received, their division in each of such years between the taxpayer and his wife did not constitute gifts of a moiety thereof from the taxpayer to his wife. (R. 66-72.) Accordingly, the Tax Court reversed the Commissioner's imposition of the gift tax thereon.

STATEMENT OF POINTS TO BE URGED

1. The Tax Court erred in holding that Congress did not intend to include in Section 1000(d) of the Internal Revenue Code a division of community property between the spouses into the separate property of each, and in striking down Section 86.2(c) of Treasury Regulations 108 to that effect.

2. The Tax Court erred in refusing to sustain the Commissioner's deficiency determinations in taxpayer's gift taxes for the gift tax years 1943, 1944 and 1945 and in entering its decisions to the effect that there were no deficiencies in such taxes in those years.

SUMMARY OF ARGUMENT

I

The January 1, 1939, agreement between the taxpayer and his wife did not preclude the imposition of the gift

tax upon the taxpayer under Sections 1000(a) and (d) and 1002 of the Internal Revenue Code.

A. The Tax Court found that despite the January 1, 1939, agreement the taxpayer's earnings continued to be the community property of himself and his wife in the gift tax years here in question, in which they were received. Such finding is supported by the evidence and should be sustained.

B. Even assuming that the January 1, 1939, agreement was effective to convert such earnings into the separate property of the spouses, it was nevertheless ineffective to prevent the application of Section 1000(d). Such an agreement is to be regarded as being merely an anticipatory arrangement which could not prevent the imposition of the tax in respect of a division which actually occurred only in the taxable years. The reason is that, for purposes of the gift tax, Congress attributed the ownership of the income to the spouse who earned it. There is nothing in the cases decided by this Court or in those decided by the appellate courts of California, which prevents the application of this principle here.

II

The division of the taxpayer's earnings between himself and his wife in the taxable years in question into the separate property of each constitutes a gift by him to her of a moiety thereof in each of those years, within the meaning of Section 1000(d) of the Code.

A. Section 86.2(c) of Treasury Regulations 108 provides that Section 1000(d) applies to divisions of community property into the separate property of the spouses. In determining whether these Regulations correctly interpret Section 1000(d), the decision of this Court in the *Rickenberg* case should be put aside. In the 1948 Act, Congress has adopted the construction of

Section 1000(d) placed thereon by the Regulations. Thus, by Section 812(e)(2)(C)(i) and 1004(a)(3)(F)(iii), which were added to the Code by the 1948 Act, Congress included in the estate and gift tax bases, for marital deduction purposes, divisions of community property made during the period in which the 1942 estate and gift tax amendments to the Code were effective. The obvious reason is that, during that period, the gift tax was payable in respect of such divisions under Section 1000(d) and the Regulations. The language of Section 1000(d) clearly covers a transfer by division of the community property between the spouses. The basic premise of Section 811(d)(5) relating to the estate tax and of Section 1000(d) relating to the gift tax is that Congress attributed the ownership of the community property to the spouse to whom it was economically attributable, in disregard of state law which attributes the ownership of one-half thereof to each spouse. It was within the power of Congress to do so. The statute does not prohibit the result achieved by the Regulations, and there is no possible reason for assuming that Congress did not intend to achieve such a result. To the contrary, the section would fail of its purpose to equalize the tax between common law and community property states, unless Section 1000(d) encompassed interspousal transfers of community property. The question is not whether the Regulations are free from all doubt, but whether they are reasonable; and, before they may be stricken down, it must appear that they are plainly inconsistent with the statute. That is not the situation here; for, as stated, the Regulations are in harmony with the statute and obviously implement the purpose of Congress to equalize the tax burden throughout the United States; and, to that end, they disregard the differences in the local laws of property. In this connection, the term "gifts," used in the statute, has no com-

mon law connotation, and a donative intent is not required. It, moreover, includes the abandonment or relinquishment of rights in property; and the shifting of the husband's rights in the wife's half of the property is an adequate basis for the tax here.

B. There was no adequate and full consideration in money or money's worth for the transfer, within the meaning of Section 1002. No common law consideration is necessary. Mutual promises are insufficient to satisfy the statutory requirements. The consideration must benefit the donor in money or money's worth, and must do so adequately and fully. Neither benefit nor detriment to the donee is consideration. The purpose of Congress is enacting Section 1000(d) was to reach those gifts which are thereby withdrawn from the donor's estate. Moreover, ordinarily interspousal transactions are not business transactions, and, unless they are, they do not fall within the ambit of Section 1002. In any case, Congress would have done a futile act in imposing the gift tax upon divisions of community property, in order to equalize the tax, if it were to be defeated by the fact that, as a result, each spouse received a moiety of the property of equal value, which, indeed, each already "owned."

ARGUMENT

Preliminary

The Tax Court rejected the taxpayer's contention that, in virtue of the agreement entered into between him and his wife on January 1, 1939, the taxpayer's earnings in each of the gift tax years 1943, 1944 and 1945 did not constitute community property. On the other hand, the Tax Court rejected the Commissioner's contention that the division of such earnings in each of such years resulted in a gift in each year by the taxpayer to his wife of a moiety of such earnings under

Sections 1000(a) and (d) and 1002 of the Internal Revenue Code (Appendix, *infra*). Accordingly, the Tax Court expunged the deficiencies in gift taxes determined by the Commissioner against the taxpayer in each of such years.

Since the taxpayer has already indicated that he intends here to renew his contention that his 1943, 1944 and 1945 earnings did not constitute community property in each of those years, but constituted the separate property of himself and his wife in virtue of the 1939 agreement, we shall anticipate such contention and address our first point thereto. In this connection, we shall, however, further point out that, even assuming the agreement to have been effective to convert the taxpayer's earnings from community into the separate property of the spouses, still, under familiar principles, the taxpayer cannot by virtue of the agreement escape the impact of Section 1000(d) upon the division of such earnings in the year in which he earned them and in which they were received by him, if such division would, except for the agreement, attract the tax. And this leaves for discussion under our second point what we regard as the error of the Tax Court in holding that the division of such earnings in each of those years between the taxpayer and his wife did not constitute taxable gifts by him to her of a moiety thereof, under the above-mentioned sections.[1]

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[1] Since we cannot, of course, anticipate the full course of the taxpayer's contention with regard to the character of the agreement, we must necessarily reserve our right to answer such argument in a reply brief.

I

The January 1, 1939, Agreement Between the Taxpayer and His Wife Did Not Preclude the Imposition of the Gift Tax Upon the Taxpayer under Sections 1000(a) and (d) and 1002 of the Code in Respect of the Division of Community Property Between Him and His Wife

The Tax Court found that, despite the January 1, 1939, agreement between the taxpayer and his wife, the salaries and other compensation which the taxpayer received from his employers continued to be the community property of himself and his wife. We think the evidence amply supports that finding. However, the taxpayer cannot prevail here, even if his present interpretation of the agreement is accepted, for under well-recognized principles of law such an anticipatory arrangement cannot serve to defeat the tax. We shall present these points separately. Thus, under our subpoint A, we shall undertake to show that evidence sustains the Tax Court's finding, and under subpoint B that, in any event, the agreement cannot prevent the division of the actual community property in the gift tax years here in question from attracting the tax.

A. *The taxpayer's 1943, 1944 and 1945 earnings constituted community property in each of those years*

For a number of years prior to 1939 the taxpayer and his wife had regularly divided his earnings between them as and when he received them. On January 1, 1939, they entered into an oral agreement to divide their community property into separate property. The agreement was, however, indefinite both as to its character and as to its effectiveness in point of time.

The only witness called to testify with regard thereto was the taxpayer himself. He stated that there was an agreement on January 1, 1939, between himself and his wife with respect to salary or compensation for

services to be rendered by him in the future; that he and his wife had always divided his salary and that such division was continued under the agreement and took place month by month; also, that under the agreement the community property owned by him and his wife at the time it was entered into was then divided physically between them, she receiving certain securities and he keeping certain others. (R. 33.) Further, with regard to the division of his salary or compensation, he said that, under the agreement, one-half thereof was to be his wife's. (R. 34.) By this he referred to the "salaries and directors' fees," which he expected to earn in the future (R. 37), for that was "the only means of compensation outside of dividends and interest" (R. 38). It appeared in the course of his testimony that in an affidavit attached to his gift tax return for 1943 he had stated he and his wife had "agreed that all income to be received thereafter from salary or other compensation for personal services which would otherwise have been received as the community income should be received by each as his or her separate income or property." (R. 38.) He explained, however, the language used by him in this affidavit did not purport to be his actual language but merely his recollection of the circumstances. (R. 39.) He stated the occasion for making the agreement was that he had been apprised of a change in the income tax act, and that the division of the salaries he had been making was more or less questioned by the Bureau of Internal Revenue. (R. 39.) And, in answer to a question propounded by the Tax Court as to whether or not the agreement was entered into on the advice of counsel, he said he thought so. (R. 41.)

But, after repeating his statement that the agreement had been entered into because of questions raised by the Bureau and in order to eliminate controversy

with respect of the community property, he again said that under the agreement one-half of his salary and personal earnings was to be his wife's property; that she had no earnings since she had never been employed. (R. 42.)

As to the term of the agreement the taxpayer said that, as far as he knew, it was to continue for the rest of their lives (R. 34), and that he did not understand he could terminate it without his wife's consent (R. 42).

The taxpayer argued below that the agreement was effective not only to divide their existing community property between himself and his wife into the separate property of each, but his future earnings as well. The Tax Court's holding, however, is to the effect that such was not the effect of the agreement in so far as it concerned the taxpayer's future earnings and we agree with that conclusion. As stated, the agreement was not only oral and indefinite, but was made solely because of a controversy which had arisen between the taxpayer and the Bureau of Internal Revenue as to the character of some of his property, that is, whether it was his separate property or community property. The exact nature of the controversy is not disclosed, but it is apparent that the agreement was entered into on the advice of counsel and for the sole purpose of affecting tax consequences. (R. 39, 41, 42.)

This Court has held, speaking through Judge Dietrich, that in interpreting an equivocal transaction, such as we obviously have here, its motives may be considered as bearing upon its real nature. *Brunton* v. *Commissioner,* 42 F. 2d 81, 82. Similarly, in *Texas & N. O. R. Co.* v. *Ry. Clerks,* 281 U. S. 548, cited by Judge Dietrich in the *Brunton* case, Mr. Chief Justice Hughes, speaking for a unanimous Court said (pp. 559-560):

> Motive is a persuasive interpreter of equivocal conduct, and the petitioners are not entitled to

> complain because their activities were viewed in the light of manifest interest and purpose. The most that can be said in favor of the petitioners on the questions of fact is that the evidence permits conflicting inferences, and this is not enough.

Moreover, as the Fourth Circuit said in *Tazewell Electric Light & Power Co.* v. *Strother,* 84 F. 2d 327, in such circumstances, the transaction is to be construed jealously against the taxpayer.

It is, of course, well settled that the trier of the fact is not bound by the declaration of a purpose made by an interested party, but is free to find from all the facts what the real situation was. See *Helvering* v. *Nat. Grocery Co.,* 304 U. S. 282, 295; *Helvering* v. *Stock Yards Co.,* 318 U. S. 693, 701; *Rand* v. *Helvering,* 77 F. 2d 450 (C.A. 8th); *United States* v. *Washington Dehydrated Food Co.,* 89 F. 2d 606, 609 (C.A. 8th). The Tax Court is well aware of this principle and has again and again been guided by it, often with the approval of the appellate courts. See, e.g., *William C. De Mille Productions, Inc.,* v. *Commissioner,* 30 B.T.A. 826, 829; *Reynard Corp.* v. *Commissioner,* 37 B.T.A. 552, 563; *R. L. Blaffer & Co.* v. *Commissioner,* 37 B.T.A. 851, 856, affirmed 103 F. 2d 487 (C.A. 5th), certiorari denied 308 U. S. 576, rehearing denied, 308 U. S. 635; *W. S. Farish & Co.* v. *Commissioner,* 38 B.T.A. 150, 158, affirmed 104 F. 2d 833 C.A. 5th); *Schoenberg* v. *Commissioner,* 30 B.T.A. 659, 661, affirmed 77 F. 2d 446 (C.A. 8th), certiorari denied 296 U. S. 586; *Seymour* v. *Commissioner,* 27 B.T.A. 403, 405; *Powell* v. *Commissioner,* 34 B.T.A. 655, 659. It is, moreover, wholly immaterial that the Tax Court did not say in so many words that it did not believe the taxpayer's declaration of purpose in making the agreement, if by his testimony he intended to be understood as implying that by the agreement he and his wife intended to convert his future earnings into

separate property. It is unnecessary for the Tax Court to state that it did not believe the taxpayer in his declarations of purpose if such was their purport. Simply, to say as the Tax Court did, that the agreement did not include or relate to the taxpayer's future salary and earnings and that there was no binding agreement or obligation that he would divide his earnings with his wife in the future, and that, therefore, the payments of salary as received by him from his employer continued to be community property of himself and his wife, is more polite and less offensive, and at the same time equally sufficient. *Stone* v. *United States,* 164 U. S. 380, 382. We submit that in the circumstances it is inappropriate to force a contrary conclusion upon the Tax Court.

Taking, then, the indefiniteness of the agreement, as well as its purpose to affect undisclosed tax consequences, into consideration, it is obvious we think that the Tax Court did not err in reaching the conclusion that the agreement was not intended to and did not in point of fact serve to impress the future earnings of the taxpayer with the character of separate property. Thus, assuming that an agreement could have been framed so as effectively to convert future earnings into separate property, as this Court held it could be in *Earl* v. *Commissioner,* 30 F. 2d 898, reversed on other grounds, in *Lucas* v. *Earl,* 281 U. S. 111, 115, the finding here is that such was not the agreement, and, as we have said, that finding should not be disturbed.

In this connection, it is to be noted that, in *Earl* v. *Commissioner, supra,* this Court distinguished its prior decision in *Blair* v. *Roth,* 22 F. 2d 932, 934, on the sole ground that the agreements in the two cases were different. Thus, in the *Roth* case, it regarded an agreement similar to that here as being one merely for the future assignment by each of the parties of one-half of his or

her earnings to the other. After stating that the Commissioner did not question that, under the California statute and decisions, referring to Section 159 and Section 160 of the Civil Code and *Wren* v. *Wren,* 100 Cal. 276; *Kaltschmidt* v. *Weber,* 145 Cal. 596; *Smith* v. *Smith,* 47 Cal. App. 650, and *Perkins* v. *Sunset T. & T. Co.,* 155 Cal. 712, a husband and wife domiciled in that state may make valid agreements relating to either their separate or their community property or that it would be competent by appropriate agreement between them to constitute the earnings of the wife her separate property, the Court, also speaking through Judge Dietrich, said (p. 934):

> In essence his [the Commissioner's] contention is that, at most, the agreement here was for an assignment by each of the parties of one-half of his or her earnings to the other; that, at the instant they were received, the salaries were, by the law, impressed with the status of community property, and were taxable with reference to that status; and that the obligation to pay the tax so computed could not be escaped by contributing such incomes to the so-called partnership between the two members of the community, any more effectually than by contributing it to a like enterprise as between one member of the community and a third person. In this view we concur.

It is further to be noted that in the case of *Belcher* v. *Lucas,* 39 F. 2d 74, which was decided by this Court after the *Earl* case had been reversed by the Supreme Court, it in turn distinguished its decision in that case. Here again the distinction was based upon the difference in the nature of the agreements in the two cases. Thus, speaking of the agreement in the *Belcher* case, this Court in its opinion in that case said (p. 75):

> Reliance is had upon an oral agreement made prior to the marriage of petitioner and his wife,

which occurred on December 5, 1903, at Los Angeles, Cal., under which, to use the language of his brief, "it was understood that both would continue in business, that all earnings, income, and properties acquired by both during their married life would be owned by them fifty-fifty, and that they would be equal partners in all respects, equally owning and enjoying their earnings and acquisitions of property. * * * In accordance with this agreement, their properties, accumulations, earnings and incomes have continuously since date of marriage been combined in a common fund, from which all expenses of both have been paid, as evidenced by joint bank accounts created immediately after marriage where all salaries, earnings and profits from whatsoever source were deposited and against which account each was authorized by written contract with the banking institution to draw." Assuming that this statement by petitioner of the scope and nature of the agreement and what was done under it is correct, we are of the opinion that the view taken by the Commissioner and the Board of Tax Appeals was right. Admittedly, it is quite unimportant that the understanding originated before marriage, for, under the settled rule in California, a post-nuptial agreement of like character would be of equal efficacy. In every material respect, therefore, the case is like *Blair* v. *Roth* (C.C.A.) 22 F. (2d) 932, and it is ruled by our decision therein. See, also, *Lucas, Com'r* v. *Earl,* 50 S. Ct. 241, 74 L. Ed. — (United States Supreme Court Decision, March 17, 1930).

Thus the principles announced by this Court in the *Roth* case were in no way impaired by anything this Court had said in the *Earl* case, and we know of no decision of either this Court or of a California appellate court rendered since which has done so. It is furthermore to be noted in this connection that, while in its decision in *Lucas* v. *Earl, supra,* the Supreme Court did not specifically answer the taxpayer's contrary conten-

tion, because it decided that case on a construction of the federal statute, nevertheless, it went out of its way emphatically to suggest that, at least for federal tax purposes, the earnings would be regarded as vesting in him who had earned them for a sufficient length of time to impress them with the status of his earnings.

And this brings us to a consideration of the question whether, even assuming that the taxpayer's future earnings were actually converted into the separate property of himself and his wife by the agreement, that fact was effective to prevent the application of Section 1000(d) to the actual division which occurred in each of the taxable years.

B. *Assuming that the agreement was effective to convert the taxpayer's future earnings into the separate property of the taxpayer and his wife, this was nevertheless ineffective to prevent the application of Section 1000(d)*

Assuming, then, that the agreement is to be given the same effect as was given by this Court to the agreement in the *Earl* case, it still does not follow that the conversion will escape the impact of Section 1000(d), provided, of course, that such conversion resulted in a gift which, as has already been stated, we shall undertake to demonstrate under the second point of our argument. In other words, the assumption here is that the taxpayer's earnings were not intended to be community property because of the agreement, and our argument under this point proceeds on that assumption.

At the outset, we submit that, if the *income* tax statute must be construed so as to avoid the technical results of such an agreement, as the Supreme Court said it must be in *Lucas* v. *Earl, supra,* then obviously the *gift* tax statute here in question must likewise be so construed; for the indubitable purpose of Section 1000(d) is to

attribute a gift of property to the husband unless the property is economically attributable to the wife, regardless of the fact that under community property law one-half thereof is regarded as being owned by and vested in each of the spouses. *A fortiori, Lucas* v. *Earl* is applicable, for therein the Supreme Court said (pp. 114-115):

> There is no doubt that the statute could tax salaries to those who earned them and provide that the tax could not be escaped by anticipatory arrangements and contracts however skilfully devised to prevent the salary when paid from vesting even for a second in the man who earned it. That seems to us the import of the statute before us and we think that no distinction can be taken according to the motives leading to the arrangement by which the fruits are attributed to a different tree from that on which they grew.

Indeed, the reason for so holding here is even more obvious than it was in respect of the income tax provision. For here Section 1000(d) expressly, instead of only implicitly as in the case of the income tax section, provides that the gift tax is to be imposed upon the husband unless the property is economically attributable to the wife.

Moreover, even though it is assumed that the agreement of January 1, 1939, was intended to convert future earnings of the taxpayer, which would be community property, into separate property of the two spouses, it is not until the right to the earnings accrues that a gift thereof can become effective. It was not until the taxpayer became entitled to and received the earnings in the taxable years that an actual conversion could occur. Thus, only when the earnings came into existence, could there be a completed transfer of them by gift through the medium of dividing them. Assuredly, the

agreement would not have prevented the imposition of the tax if the gift of the taxpayer's earnings had been made to a third person. It follows that it could not defeat the tax if the gift was made to the taxpayer's wife.

Obviously a contention that Congress intended to require that the property retain its technical status of community property as an indispensable condition to the imposition of the tax under Section 1000(d) would be feckless in the light of the obvious Congressional purpose to capture the tax on transfers made by him to whom the subject of the gift was economically attributable, despite the fact that it was community property. The emphasis in Section 1000(d) is not on the fact that the property is community property. Its purpose is not to levy the tax on gifts of community property because the gift is of such property. Its purpose is rather to place the burden of this tax upon the spouse to whom community property is economically attributable, so that by necessary implication Section 1000(d) strikes at anticipatory arrangements which, by depriving the property of its community property status, would serve only to emasculate the statute and to defeat its manifest purpose. This is particularly true when, as here, as a result of such an arrangement, both the title and the ownership of the property is left in substantially the same situation as it was as community property, but out of the reach of the statute unless the arrangement is disregarded.

Subsequent decisions of the Supreme Court in which the doctrine of *Lucas* v. *Earl, supra,* has been applied make it clear that the Court regarded the assignment of the income in that case as complete before the taxable year.

Thus in *Burnet* v. *Leininger,* 285 U. S. 136, 142, the Court expressly assumed that Mrs. Leininger, the assignee of one-half of the income received by her husband from a partnership, had become the beneficial

owner of such half, saying that it was still true that he, and not she, was the member of the firm, and that she had only a derivative interest. So in *Burnet* v. *Wells,* 289 U. S. 670, 677, the Court said, citing both the *Earl* and *Leininger* cases in support thereof, as well as other decisions following them, that at times escape from the tax had been blocked by the resources of the judicial processes without the aid of legislation, and that in these and other cases, there had been a progressive endeavor by the Congress and the courts to bring about a correspondence between the legal concept of ownership and the economic reality of enjoyment or fruition, and that, "Of a piece with that endeavor is the statute now assailed." Could it possibly be denied that of a piece with that endeavor is the statute here assailed?

Again, in *United States* v. *Joliet & Chicago R. Co.,* 315 U. S. 44, 46, the Court said *Lucas* v. *Earl, supra,* had held that a husband's salary was taxable to him though by contract with his wife half of it vested in her when paid. In *Helvering* v. *Horst,* 311 U. S. 112, 114-115, the Court pointed out that in both the *Earl* and *Leininger* cases the assignment of compensation for services had preceded the rendition of the services, and in *Commissioner* v. *Harmon,* 323 U. S. 44, 46, the Court said:

> Under *Lucas* v. *Earl* an assignment of income to be earned or to accrue in the future, even though authorized by state law and irrevocable in character, is ineffective to render the income immune from taxation as that of the assignor.

Finally, in *Poe* v. *Seaborn,* 282 U. S. 101, 117, the Court said:

> In the *Earl* case a husband and wife contracted that any property they had or might thereafter acquire in any way, either by earnings (including

> salaries, fees, etc.), or any rights by contract or otherwise, "shall be treated and considered and hereby is declared to be received held taken and owned by us as joint tenants . . ." We held that, assuming the validity of the contract under local law, it still remained true that the husband's professional fees, earned in years subsequent to the date of the contract, were his individual income, "derived from salaries, wages, or compensation for personal services" under §§ 210, 211, 212 (a) and 213 of the Revenue Act of 1918. The very assignment in that case was bottomed on the fact that the earnings would be the husband's property, else there would have been nothing on which it could operate.

To be sure, the Court concluded that, in view of the fact that the case involved the income tax on community property, a different question was presented, because, under community property law, "the earnings are never the property of the husband, but that of the community." But it was precisely that situation which Congress intended to overcome in enacting Section 1000(d) so far as concerns the taxation of gifts of community property, including the earnings of either spouse. And it did so by providing, in effect, that the ownership of community property was for gift tax purposes attributable to the spouse to whom it was economically attributable.[2] If Congress had similarly attributed the ownership of such property for income tax purposes to the spouse to whom it was economically attributable, there could, of course, be no question that the principle of *Lucas* v. *Earl, supra,* would be applicable. No reason is perceived, therefore, why it should not apply to Section 1000(d).

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[2] See H. Rep. No. 2333, 77th Cong., 2d Sess., p. 169 (1942-2 Cum. Bull. 372, 475), as also S. Rep. No. 1631, same Cong. and Sess., pp. 231-233, 243 (1942-2 Cum. Bull. 504).

It should in passing be noted that nothing said by this Court in either *Johnson* v. *United States,* 135 F. 2d 125, or in *Rogan* v. *Kammerdiner,* 140 F. 2d 569, detracts from these considerations. In the *Johnson* case, the assignment was of income which had already been earned; and in the *Kammerdiner* case the question was whether property jointly held at the wife's death was economically attributable to the surviving husband. Similarly, in *Commissioner* v. *Giannini,* 129 F. 2d 638 (C.A. 9th), the sole question was whether the income which had been attributed to the taxpayer had in fact been beneficially received by him.

Moreover, neither the case of *Helvering* v. *Hickman,* 70 F. 2d 985 (C.A. 9th), upon which the taxpayer heavily relied below, nor the case of *Van Every* v. *Commissioner,* 108 F. 2d 650 (C.A. 9th), which the Court regarded as being on all-fours with the *Hickman* case, in any way affects the validity of the conclusion that the division of the taxpayer's earnings attracts the tax here in question even if they were converted into separate property by the agreement. Both of these cases involved a relinquishment by one spouse of the earnings of the other; and, as this Court pointed out in the *Hickman* case, p. 987, the result which the agreements achieved in them is precisely the result which the statute involved in *Lucas* v. *Earl* intended to achieve, namely, to attribute the income for income tax purposes to the spouse who had earned it. It was for this reason that the Court thought the principles of that case did not serve to deprive the agreements of their normal effect for federal income tax purposes. There was, therefore, no reason for not recognizing the effectiveness of the agreement for federal tax purposes in either the *Hickman* or the *Van Every* case, and there is no necessity for inquiring whether, in some other situation, such an agreement should not be given effect to defeat the tax. As indicated, that question

was not before this Court in either case and was, therefore, not answered by it in either of them. But the statute here also intended to achieve the same result for gift tax purposes, i.e., to attribute the gift of income to the spouse to whom it was economically attributable.

We, therefore, respectfully submit that the finding of the Tax Court that the agreement did not convert the property from community to separate property is supported by the evidence and should not be reversed; but that, if on the other hand it is thought that the agreement effected such conversion, then that it was nevertheless ineffective to prevent the application of Section 1000(d).

II

The Division of the Taxpayer's Earnings Between Himself and His Wife in the Taxable Years in Question Into the Separate Property of Each Constitutes a Gift by Him to Her of a Moiety Thereof in Each of Those Years Within the Meaning of Section 1000(d) of the Code

In addition to the primary question involving the construction of Section 1000(d) of the Code, the taxpayer argued in the Tax Court that, if the division of the community property of himself and his wife between them constituted a transfer within the meaning of Section 1000(a) it was for an adequate and full consideration in money or money's worth, within the meaning of Section 1002. We assume that the taxpayer will renew that contention here. Consequently, we shall also divide this part of our argument into two parts. Thus, under subpoint A, we shall undertake to show that Section 1000(d) comprehends a division of community property into the separate property of each spouse, and under subpoint B shall undertake to demonstrate that the taxpayer did not receive such consideration within the meaning of Section 1002.

A. *Section 1000(d) applies to divisions of community property into the separate property of the spouses*

The Tax Court's rejection of the Commissioner's contention that Section 1000(d) embraces a division of community property between the spouses, as the applicable Treasury Regulations, namely, Section 86.2(c) (Appendix, *infra*), provide, involves a tissue of errors, the most egregious, and indeed all comprehending of which is the fact that it struck down these Regulations.

We assume, however, that the taxpayer will argue that this Court has already, in effect, itself struck down these Regulations in the case of *Rickenberg* v. *Commissioner,* 177 F. 2d 114, because therein the Court not only struck down the cognate estate tax Regulations, but particularly because, in its opinion (p. 117, fn. 3) it referred to the fact that, in the case at bar, the Tax Court had struck down the gift tax Regulations here involved. The contention assumes, of course, that the Court referred to this fact in support of its action in striking down, in its turn, the estate tax Regulations. However, even if we regard such a conclusion to be justified, we do not understand that the Court intended by its decision in the *Rickenberg* case to foreclose the Government in fully and adequately presenting its contentions in the case at bar that the provision of Section 86.2(c) of Treasury Regulations 108 is valid in providing that a division of community property between the spouses into the separate property of each is within Section 1000 (d). In any case, we cannot accept as correct the action of this Court in striking down Section 81.15 of Treasury Regulations 105, promulgated to carry Section 811(d)(5) of the estate tax statute into effect, or its implicit approval of the Tax Court's action in striking down the cognate gift tax Regulations here in question.

While we do not intend to reargue the *Rickenberg* case here, nevertheless, what we have to say here in support of these Regulations will, we think, so conclusively demonstrate error in the Court's striking down the estate tax Regulations that the Court may feel itself constrained to overrule its decision in that case, as we think it should. In the meantime, the Solicitor General has authorized the filing of a petition for certiorari in the *Rickenberg* case, and the petition will no doubt be filed before this brief is filed. Thus, in any event, the decision in the *Rickenberg* case should be put aside, long enough, at least, to permit the Government fully to marshal the facts here which support its contention that the Tax Court committed grievous error in striking down the gift tax Regulations.

At the very outset, therefore, we wish to call the Court's attention to the fact that, even before the Tax Court's decision in this case was promulgated, Congress had itself accepted the construction placed by Section 86.2(c) of Treasury Regulations 108 upon Section 1000(d) as being the correct one. This is so because, by Section 361(a) of the Revenue Act of 1948, c. 168, 62 Stat. 110 (Appendix, *infra*), Congress amended Section 812 of the Internal Revenue Code so as by Subsection (e)(2)(C)(i) thereof to provide, on the one hand, for the *exclusion* from the estate tax base, for the purpose of computing the marital deduction, of conversions of community property into the separate property of the spouses effected both *prior* and *subsequent* to the period during which Section 1000(d) was effective; the corollary of this provision being the *inclusion* in the estate tax base of such conversions as were effected during the period that Section 1000(d) was effective. Similarly, by Section 372 of the 1948 Act (Appendix, *infra*), Congress amended Section 1004 of the Code so as by Subsection (a)(3)(F) (iii)

of that section to provide for the *exclusion* from the gift tax base, for the purpose of computing the marital deduction, only of conversions of community property *between the donor and the donee spouse*—mark these words—which occurred both prior to and after the period during which Section 1000(d) was effective.

The obvious reason for not excluding from such bases in both cases conversions which were effected during the period that Section 1000(d) was in effect was that, during such period such conversions were regarded by Congress as constituting taxable transfers to the spouses to whom the property was not economically attributable under Section 1000(d). Thus the striking down of the Regulations upsets the calculation of the marital deduction expressly provided by Congress, in Section 812(e)(2) in computing the estate tax and in Section 1004(a)(3) in computing the gift tax. In this connection, of course, sight should never be lost of the fact that the purpose of such marital deductions was to place citizens of common law states in a position of equality for both estate and gift tax purposes with residents of community property states. See H. Rep. No. 1274, 80th Cong., 2d Sess., pp. 24-26 (1948-1 Cum. Bull. 241, 260-261); S. Rep. No. 1013, same Cong. and Sess., pp. 26-29 (1948-1 Cum. Bull. 285, 303-306). That full equality was achieved by the 1948 amendments may well be questioned, but at least Congress thought that such amendments would serve better to equalize these taxes than the 1942 amendments had done, for both reports above referred to specifically so state, pp. 26 and 27, respectively (1948-1 Cum. Bull., pp. 261, 305, respectively).[3]

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[3] For an instructive discussion of the background of the 1948 Act, see Sugarman, Estate and Gift Tax Equalization, 36 Cal. L. Rev., 223-226 (1948).

Thus, while, as stated, under Section 812(e)(2)(C)(i) and Section 1004(a)(3)(F)(iii), community property, which is excluded from the estate and gift tax bases, includes the separate property acquired as a result of a division of community property between the spouses, when such division takes place both *before* and *after* the period during which Section 1000(d) was in effect, separate property resulting from such division occurring *during* the effective period of that Section is not treated as community property and is *included* in the bases under Sections 812(e)(2)(C)(i) and 1004(a)(3)(F)(iii) for determining the marital deduction.

We think it brooks no denial that Congress included in the estate and gift tax bases, for purposes of computing the marital deduction, conversions of community property occurring during the period in which the 1942 Amendments were in effect, because it regarded them as having constituted taxable transfers under Section 1000(d). Indeed, there is no other conceivable reason why Congress should so painstakingly have differentiated between conversions occurring during that period and those occurring both before and thereafter. See Surrey,[4] Federal Taxation of the Family—The Revenue Act of 1948, 61 Harv. L. Rev. (1948) 1097, where the author explains the exception in respect of the estate tax and the reason therefor which we have given, as follows (pp. 1124-1125):

> Some separately held property is treated as community property. In the case of community property which was converted in [the] calendar [year] 1942, or is converted after April 2, 1948, into separately held property of the spouses (including joint tenancy or any other form of joint owner-

[4] The author, Stanley S. Surrey, now at the School of Jurisprudence of the University of California, was Tax Legislation Counsel of the Treasury Department in the years 1942 to 1947, inclusive.

> ship), the separate parts are considered community property for the purpose of the 50% limitation and hence must be subtracted to find the adjusted gross estate. Since no gift tax was or is payable on such conversion, failure to require subtraction of such property for purposes of the limitation would make avoidance of the entire special community property rule relatively simple. But the safeguard adopted involves tracing problems, especially since its effectiveness demands that the artificial community property designation still apply to any separate property received in subsequent exchanges. Conversions in the period between 1942 and April 2, 1948, are not within this artificial treatment, since a gift tax was payable then.

A similar explanation is made by him at (pp. 1141-1142), of the exception in respect of the gift tax.[5]

The basis of both Sections 811(d)(5) and 1000(d), of course, is that, for estate and gift tax purposes, Congress treated the one to whom the property was economically attributable as the owner of the property, in studied disregard of the rules of state law which give to each spouse a so-called vested interest in one-half of the property. *Poe* v. *Seaborn,* 282 U. S. 101, whose doctrine was, in *United States* v. *Malcolm,* 282 U. S. 792,

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[5] Sugarman does not specifically explain, in his article referred to in fn. 3, *supra*, why under Section 812(e)(2)(C)(i) and Section 1004(a)(F)(iii) transfers of community property between husband and wife, made during the effective period of the 1942 estate and gift tax amendments, were includible in the estate and gift tax base for purposes of the marital deduction, though he does explain (pp. 269 and 273) that only such divisions as were made in 1942 and after April 2, 1947, are includible therein. However, in this connection, he points out (p. 769, fn. 168) that transfers of pre-1927 community property of the spouses, i.e., those made before and after the effective period of the 1942 amendments referred to in the text which the footnote supports, are includible, because the gift tax was paid thereon; and, as we have said, this is precisely the reason why such division under Section 1000(d) was made includible under the 1948 Act in both the estate and gift tax bases.

regarded by the Supreme Court as applicable to California post-1927 community property. See H. Rep. No. 2333, 77th Cong., 2d Sess., pp. 160, 169 (1942-2 Cum. Bull. 372, 489, 496), as well as S. Rep. No. 1631, same Cong. and Sess., pp. 231-232, 243 (1942-2 Cum. Bull. 504, 673-674, 682), already referred to in fn. 2, *supra*. Both reports expressly state that Section 811(d)(5) attributes the transfer to the spouse to whom the property is economically attributable and thus establishes a uniform federal rule for apportioning the respective contributions of the spouses regardless of varying local rules of apportionment, and that, accordingly, state presumptions are not operative against the Commissioner. Certainly, nothing could be plainer.

However, if more is required, we respectfully refer the Court to the discussion of both Sections 811(d)(5) and 1000(d) by Paul [6] in his 1946 Supplement to Federal Estate and Gift Taxation, where he says (pp. 210-211), first with regard to Section 811(d)(5):

> Although the statute [Section 811(d)(5)] does not expressly mention interspousal transfers, there is certainly no implication that it was intended to embrace only transfers to third persons. As a matter of fact, the very absence of any language of limitation is cogent evidence that none was intended. Moreover, a contrary conclusion would require one to assume that while Congress took pains to establish a special rule for community property owned by the decedent and spouse at the former's death, regardless of whether the property passes to the spouse or another, for some reason it has applied the same rule to taxable *inter vivos* transfers only if the property is bestowed upon a third

[6] Aside from being the outstanding authority on federal gift and estate taxation, Randolph E. Paul was Tax Adviser of the Treasury Department in 1942 and represented the Treasury before the Congressional Committees in connection with the 1942 Revenue Bill, which became the Revenue Act of 1942, c. 619, 56 Stat. 798. Later, of course, he served as Chief Counsel of the Treasury.

person. The anomaly becomes all the more striking when it is recalled that the provisions reaching transfers prior to death are intended to prevent avoidance of the tax which would apply if the property had been retained until death.

Following this up, Paul explains Section 1000(d) in relation to Section 811(d)(5), as follows (pp. 719-721):

> Section 1000(d) of the Code conforms closely to the basic estate tax amendments. The property is taxed to one spouse or the other on the basis of economic source. There is, however, a difference in the play of presumptions. Under the estate tax provision, which is somewhat analogous to the statute governing joint tenancies and tenancies by the entirety, there is an initial presumption that the community property is attributable to the decedent, whether husband or wife. The gift tax amendment, on the other hand, attributes community property to the husband in all cases unless the contrary is shown. Each amendment is conveniently fashioned to suit the needs of the occasion.
>
> The change in gift tax incidence is not confined to transfers of community property to third persons. According to the regulations, the amendment applies as well "to a division of such community property between husband and wife into the separate property of each, and to a transfer by the husband and wife of any part of such community property into the separate property either of the husband or of the wife, or into a joint estate or tenancy by the entirety of both spouses. In all of such cases the value of the property so transferred or so divided, as the case may be, is a gift by the husband to the extent that it exceeds the aggregate amount of the value of that portion which is shown to be economically attributable to the wife . . . and of the value of the husband's interest in such property after such transfer or division. The value of the property so transferred or so divided, as the case may be, is a gift by the wife to the extent that the portion of such value which is shown to be economically at-

tributable to her . . . exceeds the value of her interest in such property after such transfer or division."

The regulations solve, at least temporarily until the courts have spoken, the question whether Section 1000(d) extends to a division of community property between the spouses or the transformation of such property into the separate property of one of the spouses or property owned by the spouses jointly, by the entirety or in common. Few, if any, will quarrel with the amendment's effect upon transfers of community property to third persons, once strongly entrenched assumptions about the Constitution are overcome. There is a tendency, however, to place interspousal transfers within an insulated compartment, wherein community property concepts may continue an undisturbed and hence happy existence. This attitude seems to be premised upon two factors, namely, the absence from the amendment of an express reference to interspousal transfers and the wife's position as co-owner in community property theory. Before examining these factors as they affect the merits of the regulation, the effect of limiting the amendment to transfers outside the community should be noted. Under the estate tax the transfer to the wife of community property attributable to the decedent-husband is taxable to the latter's estate. It makes no difference whether the wife or a stranger succeeds to the ownership. But if the complementary gift tax provision did not include interspousal transfers, the husband would be free to effect the same result during life without payment of a commensurate tax. Moreover, even avoidance of gift tax upon transfers to third persons would be encouraged. A husband wishing to make a gift of community property to others would first divide the property into equal portions, the husband owning one and the wife the other, and at a later date each could transfer his share to the desired beneficiary. The amendment would simply be turned into a fairly useless gesture, effective only as to

those who failed to do the necessary maneuvering. It seems more reasonable to assume, however, that in enacting legislation to deal with *inter vivos* transfers of community property, Congress intended the legislation to be effective, especially since it is intended to "protect" the estate tax.

While Section 1000(d) does not expressly mention the reshuffling of ownership as between the spouses, it does not follow that the regulations have gone too far afield. The purpose of the section, reflected as well by the estate tax amendment, is to pierce the property categories of local law and to attribute ownership of the community property to one spouse or the other in the light of stated economic criteria. If—to take the simplest and most common case—the community property is completely attributable to the husband, it is treated as if it belongs solely to him. Hence it makes no difference whether the property is given to the wife or to a third person, unless the difference derives from the wife's co-ownership under local law. However, a distinction established on this basis would simply read back into the statute the very concept of ownership which engendered the discriminations calling for legislation. And it would require one to assume that the gift tax treatment of interspousal transfers was intended to diverge sharply from the status of such transfers under the estate tax, although the committee reports observe that the gift tax amendment "is similar to the estate tax amendment."[7]

Although Sections 811(d)(5) and 1000(d) do not expressly refer to interspousal transfers, the broad language used assuredly covers them, as well as transfers of community property to third persons. As stated

[7] As we have shown, the 1948 legislation completely confirms the correctness of Paul's analysis of the problem and demonstrates as baseless the criticism of it by Brown and Sherman in their article Division of Community Property as Taxable Gifts, 22 Cal. State Bar Journal 122 (1947), which the taxpayer cited and relied on below and will no doubt again cite and rely on here.

by Paul, *supra,* p. 210, "the very absence of any language of limitation is cogent evidence that none was intended," citing, fn. 34, *Commissioner* v. *Becks Estate,* 129 F. 2d 243, 244-246 (C.A. 2d). Here the avowed purpose of Congress was, as stated, so far as it was possible by the method adopted, to do away with the preferential estate and gift tax treatment of community property and to equalize these taxes as between citizens of common law and community property states. But this could fully be accomplished by such means only by regarding the spouse to whom the community property was economically attributable as its owner not only for purposes of transfer to third persons, but for purposes of interspousal transfers as well. The basic premise of both Sections 811(d)(5) and 1000(d) is that the spouse who is the economical source of community property has a sufficient property interest in the other spouse's half to justify inclusion of its value on the one hand in the decedent's gross estate and on the other in the total amount of gifts when it has been conveyed *inter vivos* not only to a third person, but to the other spouse, as well, by a transfer described in Section 1000(d). The statute not only does not exempt from its terms interspousal transfers, but no rational reason has or can be suggested for assuming that Congress intended to exempt them. To the contrary, the statute focuses on the transfer by the husband of his interest in his wife's community half of the property as a taxable event, and where there has been such a transfer it obviously is irrelevant who might be the transferee. The statute would fail of its purpose wholly to equalize these taxes as between citizens of common law and community property law states within the framework of the 1942 amendments, unless Section 1000(d) encompassed interspousal transfers. Thus if, nevertheless, such an exception is made by the courts, it will

be nothing short of a wholly unwarranted judicial graft upon the statute, for such an exception is in the teeth of the Congressional purpose to equalize the tax and, to the extent of the exception, thwarts such purpose.

Assuredly, there is nothing to prevent Congress from treating the husband, except to the extent the community property is economically attributable to the wife, as the owner thereof and accordingly taxing him upon its transfer to the other spouse. His exclusive management and control are sufficient for this insofar as the wife's half of the property is concerned.[8] The power of Congress to regard the shifting of the husband's control over the wife's half of the community property as a sufficient basis for both estate and gift tax purposes can, of course, no longer be questioned. *Fernandez* v. *Wiener,* 326 U. S. 340; *United States* v. *Rompel,* 326 U. S. 367. But to concede, as it must be conceded, that the husband may be treated as the owner of that property interest in respect of transfers to a third person, is likewise to concede that he may be treated as such owner in respect of an interspousal transfer. It would seem to follow that since he must be so considered in the one case, he must likewise be so considered in the other, as the Regulations, correctly, we think, provide.

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[8] Section 161(a) of Deering's Civil Code of California (1949) expressly provides that the wife's present, existing and equal interest in the community property shall be under the management and control of the husband. Under Section 172 of the Civil Code the husband has management and control of community personal property, with like absolute power of disposition, other than testamentary, as he has over his separate property, except that he can not give it away without a valuable consideration and he can not dispose of the home furnishings or the apparel of the wife or minor children without the wife's written consent. The wife also, under Section 172a, must join in executing any conveyance, or lease in excess of one year, of community real estate. Under these sections the community property, both real and personal, may be used to pay the husband's separate debt and tort liabilities. *Grolemund* v. *Cafferata,* 17 Cal. 2d 679, certiorari denied, 314 U. S. 612.

As the Supreme Court said in *Commissioner* v. *South Texas Co.,* 333 U. S. 496, 501:

> This Court has many times declared that Treasury regulations must be sustained unless unreasonable and plainly inconsistent with the revenue statutes and that they constitute contemporaneous constructions by those charged with administration of these statutes which should not be overruled except for weighty reasons.

citing *Fawcus Machine Co.* v. *United States,* 282 U.S. 375. The question is not whether the Regulations are free from doubt, but whether they are reasonable. *Brewster* v. *Gage,* 280 U. S. 327. The Regulations here not only state a conclusion in accord with, and indeed demanded by the statutory language itself, but they are reasonable; for, as we have repeatedly said, they implement the purpose of Congress to give geographic uniformity to the estate and gift tax statutes, so that transfers of the property from one spouse to the other having similar economic aspects shall be treated alike taxwise throughout the United States. Moreover, as already pointed out, Congress in connection with Sections 361 and 362 of the Revenue Act of 1948 has approved the Regulations. In this connection, it has been held that a Regulation is not unreasonable because it defines property for federal tax purposes in disregard of local law. See *United States* v. *Pelzer,* 312 U. S. 399, 402, 403, and cases there cited, and particularly the decision of this Court in *United States* v. *Lambeth,* 176 F. 2d 810. Here, of course, the statute itself disregards the wife's "ownership" of her community half under local law and the Regulations do not go beyond the statute in that respect.

Of course, what has been said disposes of the Tax Court's notion that the wife's ownership of one-half of the community property under California law is a con-

trolling consideration, and that because of such ownership there cannot be a "gift" for federal gift tax purposes of such half from the husband to the wife, with the result that a division of the community property between them cannot be regarded as a transfer from the husband to her of such half. Also disposed of, we think, is the Tax Court's corollary notion that, because of the status of the title to community property under local law, no intention can be imputed to Congress to attribute the ownership thereof to the spouse to whom it was economically attributable, at least not for the purpose of imposing a gift tax upon its transfer to the other spouse.

Further disposed of is the Tax Court's definition of the term "gift" as used in the statute. Sections 1000(a) and (d) and 1002 must, of course, be read together. In combination, they provide for the imposition of the gift tax upon a transfer of property to the extent that the transferor has not received an adequate and full consideration in money or money's worth, including transfers of community property which are deemed to be made by the husband, except to the extent the property is economically attributable to the wife. Obviously, Congress did not use the word "gift" in Section 1000(d) in a different connotation from what it used the word "transfer" in Section 1000(a) taken in conjunction with the provisions of Section 1002 with regard to consideration; and obviously also Congress regarded the husband's interest in the wife's community half of the property as property, the transfer of which by him was to be taxed.

The Supreme Court has repeatedly said that the definition of the word "gift" as used in the statute is not, as the Tax Court supposed, the common law definition thereof, but embraces any transfer of an interest in property (other than one made in the ordinary course

of business), to the extent that it was made for less than an adequate and full consideration in money or money's worth, and that no donative intent is necessary. *Commissioner* v. *Wemyss,* 324 U. S. 303. See also *Merrill* v. *Fahs,* 324 U. S. 308. Indeed, this Court has itself so held. *Commissioner* v. *Greene,* 119 F. 2d 383, 386. As the Supreme Court pointed out in the *Wemyss* case, p. 306, Congress used the word "gifts" in its broadest and most comprehensive sense, choosing not to require an ascertainment of what too often is an elusive state of mind. See also to the same effect *Smith* v. *Shaughnessy,* 318 U. S. 176, 180. Hence, for purposes of the gift tax, as the Supreme Court said in the *Wemyss* case, Congress not only dispensed with the test of "donative intent," but formulated a much more workable external test, namely, that, when "property is transferred for less than an adequate and full consideration in money or money's worth," the excess of such money value "shall for the purpose of the tax imposed by this title, be deemed a gift . . ."; and that, moreover, Treasury Regulations had emphasized that common law considerations were not embodied in the gift tax.

Moreover, the definition of the term "gift" includes the abandonment of control over the property. *Smith* v. *Shaughnessy, supra,* p. 181; *Merrill* v. *Fahs, supra*; *Commissioner* v. *Bristol,* 121 F. 2d 129 (C. A. 1st). The relinquishment of a right in property satisfies all of the requirements of the statute. *Burnet* v. *Guggenheim,* 288 U. S. 280.

Indeed, the tax is not laid on the property at all, but on the donor's disposition of his interest therein, whatever that may be. *Phipps* v. *Commissioner,* 91 F. 2d 627 (C. A. 10th).

It follows that the Tax Court's definition of the term "gift" is erroneous and does not serve to advance the taxpayer's contention.

Finally, on this phase of the case, it should be noted that the gift tax is an adjunct to the estate tax, its purpose being to prevent tax-free depletion of decedents' estates by requiring that the transferor receive not only an adequate and full consideration, but that this be in money or money's worth. *Estate of Sanford* v. *Commissioner,* 308 U. S. 39, 43; *Smith* v. *Shaughnessy, supra,* p. 180; *Merrill* v. *Fahs, supra,* p. 311; *Commissioner* v. *Bristol, supra.* Thus, contrary to the Tax Court's view, in the case at bar, the transfer amply satisfies the requirement of Section 1000(d) in that the taxpayer relinquished his control of the property, or of his wife's half.

There is another argument which the taxpayer made below and which he will no doubt renew here, and that is that there is no warrant in the statute for the further provision in Section 86.2 (c) of Treasury Regulations 108 to the effect that a transfer of separate property into community property is not subject to gift taxes under Section 1000(d) as theretofore. The rationale of that provision, however, lies in the fact that under this Section the economic right of the property determines the ownership for gift tax purposes. It follows that a transfer of separate property by the husband to the community must be regarded as a transfer by the owner to himself. Paul explains this fully in his 1946 Supplement to Federal Estate and Gift Taxation, p. 721:

> Pursuing further the basic theory of a redefined "tax ownership," the regulations add that no gift tax liability is imposed upon "a transfer on or after January 1, 1943, of separate property of either spouse into community property." Hence, if a husband transforms his separate property into community property there is no gift tax, since from the tax point of view he is still owner of the property. On the other hand, a subsequent shift of

ownership from the community to the wife would constitute a taxable transfer.

Thus, one after the other, the Tax Court's reasons for holding that the division of the community property here in question did not attract the gift tax have been shown to be invalid. To sum up, these are: (1) That the Regulations are invalid in that they provide that Section 1000(d) comprehends a division of community property between the spouses into separate property; (2) that Congress intended the state law to be still controlling; (3) that the division here in question did not satisfy the definition of the term "gift" as used in the statute, and (4) that a relinquishment of the husband's control over his wife's half of the community property did not do so.

This leaves for consideration the question whether the transfer here in question was for an adequate and full consideration in money or money's worth within the meaning of Section 1002.

B. *There was no adequate and full consideration in money or money's worth for the transfer within the meaning of Section 1002 of the Code*

The consideration which Section 1002 requires is not a common law consideration. See *Commissioner* v. *Wemyss, supra; Commissioner* v. *Greene, supra,* and *Commissioner* v. *Bristol, supra.* Nor are mutual promises sufficient to satisfy the statutory requirements. *Robinette* v. *Helvering,* 318 U. S. 184. The consideration must benefit the donor in terms of money and money's worth, and must do so adequately and fully; neither benefit nor detriment to the donee is consideration. *Commissioner* v. *Wemyss, supra.* Indeed, the purpose of the statute is to reach those gifts which are withdrawn from the donor's estate. *Commissioner* v.

Wemyss, supra. Moreover, interspousal transactions, although they conceivably may be such, ordinarily are not business transactions and, unless they are, they do not fall within the ambit of Section 1002. See *Taft* v. *Bowers,* 304 U. S. 351; *Commissioner* v. *Wemyss, supra; Merrill* v. *Fahs, supra; Giannini* v. *Commissioner,* 148 F. 2d 285 (C.A. 9th). And, in any case, Congress would have done a futile act in imposing a tax on the division of community property, in order to equalize the tax throughout the United States, if it were to be defeated by the very fact that, as a result, each spouse received a moiety of the property of equal value, which, indeed, each already "owned."

But, regardless of all that, neither the benefits accruing to the taxpayer from the severance here nor, for that matter, the detriments are calculable in terms of money or money's worth. They cannot, therefore, be taken into account. *Robinette* v. *Helvering, supra.* The taxpayer benefited only to the extent that, after the transfer and as a result thereof, he could make a voluntary gift of his half of the property without his wife's consent.

On the other hand, the taxpayer suffered material detriments as a result of the division, also not calculable in terms of money or money's worth, in that he was required to pay not only all his own debts out of the half interest in the property he had received, but all community debts, as well.

Moreover, specifically in the case of the estate tax, and certainly impliedly in the case of the gift tax, such division is neither to be regarded as being for an adequate and full consideration in money or money's worth, nor as implying such consideration. Certainly Congress would have done a futile act in imposing a tax upon the division of community property, if the tax were defeated by the very fact that there was a division

whereby each spouse received a moiety of the property of equal value.

We submit that the transfer does not fall within Section 1002.

CONCLUSION

For the reasons stated the decisions of the Tax Court should be reversed.

Respectfully submitted,

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or has passed from the decedent to his surviving spouse, but only to the extent that such interest is included in determining the value of the gross estate.

* * * * *

"(2) *Computation of Adjusted Gross Estate.*—

* * * * *

"(C) *Same—Conversion Into Separate Property.*—

"(i) If during the calendar year 1942 or after the date of the enactment of the Revenue Act of 1948, property held as such community property (unless considered by reason of subparagraph (B) of this paragraph as not so held) was by the decedent and the surviving spouse converted, by one transaction or a series of transactions, into separate property of the decedent and his spouse (including any form or co-ownership by them), the separate property so acquired by the decedent and any property acquired at any time by the decedent in exchange therefor (by one exchange or a series of exchanges) shall, for the purposes of clauses (i), (ii), and (iii) of subparagraph (B), be considered as 'held as such community property'.

* * * * *

(26 U.S.C. 1946 ed., Supp. II, Sec. 812.)

SEC. 371. GIFTS OF COMMUNITY PROPERTY.

Section 1000 (d) of the Internal Revenue Code (relating to gifts of property held as community property) is amended by adding at the end thereof a new sentence to read as follows: "This subsection shall be applicable only to gifts made after the calendar year 1942 and on or before the date of the enactment of the Revenue Act of 1948."

(26 U.S.C. 1946 ed., Supp. II, Sec. 1000.)

SEC. 372. MARITAL DEDUCTION.

Section 1004 (a) of the Internal Revenue Code (relating to deductions in computing net gifts in the case of a citizen or resident of the United States) is hereby amended by adding at the end thereof a new paragraph to read as follows:

"(3) *Gift to Spouse.*—

"(A) *In General.*—Where the donor transfers during the calendar year (and after the date of the enactment of the Revenue Act of 1948) by gift an interest in property to a donee who at the time of the gift is the donor's spouse—an amount with respect to such interest equal to one-half of its value.

* * * * *

"(F) *Community Property.*—

"(i) A deduction otherwise allowable under this paragraph shall be allowed only to the extent that the transfer can be shown to represent a gift of property which is not, at the time of the gift, held as community property under the law of any State, Territory, or possession of the United States, or of any foreign country.

"(ii) For the purposes of clause (i), community property (except property which is considered as community property solely by reason of the provisions of clause (iii) shall not be considered as 'held as community property' if the entire value of such property (and not merely one-half thereof) is treated as the amount of the gift.

"(iii) If during the calendar year 1942 or after the date of the enactment of the Revenue Act of 1948, property held as such community property (unless considered by reason of clause (ii) as not so held) was by the donor and the donee spouse converted, by one transaction or a series of transactions, into separate property of the donor and such spouse (includ-

ing any form of co-ownership by them), the separate property so acquired by the donor and any property acquired at any time by the donor in exchange therefor (by one exchange or a series of exchanges) shall, for the purposes of clause (i), be considered as 'held as community property'.

* * * * *

(26 U.S.C. 1946 ed., Supp. II, Sec. 1004.)

Treasury Regulations 105, promulgated under the Internal Revenue Code:

SEC. 81.15 [as amended by T. D. 5239, 1943 Cum. Bull. 1081, 1084] *Transfers during life.*—* * *

In the case of estates of decedents dying after October 21, 1942, a transfer to a third party or third parties of property held as community property by the decedent and spouse under the law of any State, Territory, or possession of the United States, or any foreign country, shall be considered, in accordance with section 811(d)(5), as added by section 402(a) of the Revenue Act of 1942, for the purposes of this section and sections 81.16 through 81.21, inclusive, to have been made by the decedent, except such part thereof as may be shown to have been received as compensation for personal services actually rendered by the spouse or derived originally from such compensation or from separate property of the spouse. The same statutory provisions apply in the case of a division of such community property between the decedent and spouse into separate property, and in the case of a transfer of any part of the community property into separate property of such spouse; in such cases, the value of the property which becomes the separate property of such spouse, with the exception stated in the preceding sentence, shall be included in the gross estate of the decedent under section 811 (c) or section 811 (d), if the other conditions of taxability under such sections exist. If in the case of a decedent who died after October 21, 1942, property

held as community property by such decedent and his spouse is transferred to themselves as joint tenants or as tenants by the entirety, the transfer is taxable under section 811(c), except with respect to such part of the property so transferred as is attributable to the spouse under the exception stated in the first sentence of this paragraph. With respect to the meaning of property derived originally from such compensation or from separate property of the spouse and to the identification required, see section 81.23.

Treasury Regulations 108, promulgated under the Internal Revenue Code:

SEC. 86.2 *Transfers Reached.*—* * *

* * * * *

(c) *Transfers of community property after 1942.*—During the calendar year 1943 and any calendar year thereafter any gift of property held as community property under the law of any State, Territory, or possession of the United States, or any foreign country constitutes a gift of the husband for the purpose of the gift tax statute (regardless of whether under the terms of the transfer the husband alone or the wife alone is designated as the donor or whether both are so designated as donors), except to the extent that such property is shown (1) to have been received as compensation for personal services actually rendered by the wife or derived originally from such compensation, or (2) to have been derived originally from separate property of the wife. The entire property comprising the gift is prima facie a gift of the husband, but any portion thereof which is shown to be economically attributable to the wife as prescribed in the preceding sentence constitutes a gift of the wife.

The rule stated in the preceding paragraph applies alike to a transfer by way of gift of community property to a third party or third parties, to a division of such community property between husband and wife into the separate property of each, and to

a transfer by the husband and wife of any part of such community property into the separate property either of the husband or of the wife, or into a joint estate or tenancy by the entirety of both spouses. In all of such cases the value of the property so transferred or so divided, as the case may be, is a gift by the husband to the extent that it exceeds the aggregate amount of the value of that portion which is shown to be economically attributable to the wife, as prescribed in the preceding paragraph, and of the value of the husband's interest in such property after such transfer or division. The value of the property so transferred or so divided, as the case may be, is a gift by the wife to the extent that the portion of such value which is shown to be economically attributable to her, as prescribed in the preceding paragraph, exceeds the value of her interest in such property after such transfer or division. See examples (5) and (6) of subsection (a) of this section. No gift tax results from a transfer on or after January 1, 1943, of separate property of either spouse into community property.

Property derived originally from compensation for personal services actually rendered by the wife or from separate property of the wife includes property that may be identified as (1) income yielded by property received as such compensation or by such separate property, and (2) property clearly traceable (by reason of acquisition in exchange, or other derivation) to property received as such compensation, to such separate property, or to such income. The rule established by this statute for apportioning the respective contributions of the spouses is applicable regardless of varying local rules of apportionment, and State presumptions are not operative against the Commissioner.

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No. 12,305

IN THE

United States Court of Appeals

For the Ninth Circuit

COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

vs.

EDWARD M. MILLS,
Respondent.

On Petition for Review of Decisions of the Tax Court of the United States.

BRIEF FOR THE RESPONDENT.

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BRIEF FOR THE RESPONDENT.

PRELIMINARY STATEMENT.

As this Court declared in *Rickenberg v. Commissioner of Internal Revenue* (9 Cir. 1949) 177 F.2d 114, footnote on page 117, certiorari denied (Feb. 6, 1950) ..... U.S. ....., this case is the gift tax corollary of that decision involving estate taxes. While there are additional sufficient reasons, discussed below, why the judgment of the Tax Court should be affirmed, the *Rickenberg* decision is decisive against the Commissioner's contentions here.

STATEMENT OF FACTS.

The statement of facts in the Commissioner's brief is sufficient except in one respect. There is nothing in the record to support the finding that the 1939 agreement did not include or relate to the future salary and earnings of the taxpayer; on the contrary, the clear and undisputed testimony requires the finding that the agreement of the parties embraced the understanding that, until changed by mutual consent, future earnings would continue to be divided equally into the separate property of each of the spouses. Our showing in this connection is in Point II, infra, pp. 15-23.

The statute and regulations involved are set out in the appendix, infra.

QUESTIONS PRESENTED.

This case presents the primary question whether the allocation of their respective shares of community property to the taxpayer and his wife as their separate property in the years 1943, 1944 and 1945 constituted a taxable gift of the wife's share from the husband to her, within the meaning of section 1000(d) of the Internal Revenue Code. This, as said above, is the precise question answered in the negative as to estate taxes by the *Rickenbery* decision.

Even if the *Rickenberg* case had been decided the other way, the question would still remain whether the agreement of January 1, 1939, between the taxpayer and his wife did not constitute one half the future earnings of the taxpayer his separate property and one half the separate property of his wife, so as to render inapplicable the sub-

sequently enacted provisions of section 1000(d). That the agreement did have this effect will be demonstrated in Point II of the argument, infra, pp. 15-23.

SUMMARY OF ARGUMENT.

I.

The conversion of the community property into the separate property of taxpayer and his wife did not result in a taxable gift under section 1000(d) of the Internal Revenue Code because, as this Court held in *Rickenberg v. Commissioner of Internal Revenue* (9 Cir. 1949) 177 F.2d 114, certiorari denied (Feb. 6, 1950) ..... U.S. ....., such a conversion is not a transfer by the taxpayer of an interest which *he* owns in property but is merely an allocation to the wife of property which *she* already owns. Furthermore, nowhere in the Revenue Act of 1942 did Congress attempt to redefine the term "gift," and section 1000(d), added to the Code by that Act, applied only when there was a gift as that term was previously understood. Section 86.2(c) of Regulations 108, purporting to make such conversions taxable gifts, is invalid because nowhere in the Code is there any statutory authority for such regulation. Even if the allocation were to be considered a transfer, still it would not be a transfer by way of gift within the meaning of section 1000(d) because the release of the wife's community interest would constitute a full and adequate consideration in money or money's worth. The marital deduction provisions of the Revenue Act of 1948 do not indicate a contrary construction of the 1942 Act.

II.

The finding of the Tax Court that the agreement of January 1, 1939, between the taxpayer and his wife did not include or relate to future earnings of the taxpayer is erroneous because there is nothing in the record which would support any such finding. The Tax Court was not free to disregard arbitrarily the uncontradicted and unimpeached testimony of the taxpayer to the contrary. A proper finding in conformity with the record in this respect would support the judgment regardless of the effect of Point I, supra.

The effect of the 1939 agreement was to constitute the future earnings of the taxpayer the separate property of each spouse to the extent of one half the earnings. If the agreement did not have this effect, then there was never any conversion of community property and no tax should be imposed.

ARGUMENT.

I.

THE ALLOCATION OF THEIR RESPECTIVE SHARES OF COMMUNITY PROPERTY TO THE TAXPAYER AND HIS WIFE AS THE SEPARATE PROPERTY OF EACH IN THE YEARS 1943, 1944 AND 1945 DID NOT CONSTITUTE A TAXABLE GIFT OF THE WIFE'S SHARE FROM THE HUSBAND TO HER, WITHIN THE MEANING OF SECTION 1000(d) OF THE INTERNAL REVENUE CODE.

We submit that the correctness of this proposition already has been affirmed by this Court in *Rickenberg v. Commissioner of Internal Revenue* (9 Cir. 1949) 177 F.2d 114, certiorari denied (Feb. 6, 1950) ..... U.S. .....,

wherein this Court held that the value of the wife's share upon such an allocation of community property, made in contemplation of the husband's death, could not be included in the deceased husband's gross estate because such an allocation did not constitute a transfer of property within the meaning of section 811(d)(5) of the Internal Revenue Code. Section 811(d)(5) provided that "a transfer of property held as community property by the decedent and surviving spouse * * * shall be considered to have been made by the decedent" for the purpose of section 811(c), under which property transferred in contemplation of death is includible in the gross estate of the decedent.

The question in the instant case is whether such an allocation of community property resulted in a taxable gift from the taxpayer to his wife within the meaning of section 1000(d) of the Internal Revenue Code. This section, which is the gift tax corollary to section 811(d)(5),[1] provides in part as follows:

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[1]Section 1000(d) and section 811(d)(5) were added to the Code by the Revenue Act of 1942 and were repealed or rendered inapplicable by the Revenue Act of 1948. Section 1000(d) is applicable to gifts made between January 1, 1943, and April 2, 1948 (Revenue Act of 1942, secs. 451, 453; Revenue Act of 1948, sec. 371). Section 811(d)(5) was effective with respect to estates of decedents dying after October 21, 1942, and before January 1, 1948 (Revenue Act of 1942, secs. 401, 402(a); Revenue Act of 1948, sec. 351(a)).

That sections 1000(d) and 811(d)(5) are correlative is demonstrated by the following statement in the report of the Senate Finance Committee on the bill which became the Revenue Act of 1942 (Senate Report No. 1631, 77th Cong., 2d Sess., C.B. 1942-2, 504, 682): "Your committee has made a technical change in this section [sec. 1000(d)] in order to make its provisions correspond more closely with the estate tax amendment relating to community property."

> "All gifts of property held as community property under the law of any State * * * shall be considered to be the gifts of the husband * * *."

The Tax Court in this case held that the allocation of community property to the taxpayer and his wife as their separate property did not constitute a taxable gift within the meaning of section 1000(d) and that the contrary provisions of section 86.2(c) of Treasury Regulations 108 are an unwarranted expansion and enlargement of the meaning of section 1000(d) (Tr. 70). This Court in the *Rickenberg* case cited the Tax Court's decision in this case with approval (117 F.2d 117) and struck down the estate tax regulations (Regs. 105, sec. 81.15) which are cognate to the gift tax regulations declared invalid by the Tax Court in this case. We submit, and petitioner impliedly concedes (Petnr. Br., p. 26) that this Court's decision in the *Rickenberg* case is decisive against the Commissioner's contentions here,[2] as the following brief analysis shows.

(a) A conversion of community property into the separate property of the spouses is not a "transfer of property."

There can be no taxable gift without a transfer of property. Section 1000(a), which contains the basic definition of what is the incidence of the gift tax, specifically states that a tax "shall be imposed upon the transfer * * * of property by gift." The word "gift" in section 1000(d) is clearly controlled by the provisions of section 1000(a). Neither section 1000(d) nor any other provision of the Revenue Act of 1942 purports to modify or amplify sec-

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[2]The Commissioner's brief in this case was filed before the denial of his petition for certiorari in the *Rickenberg* case (Petnr. Br., p. 27).

tion 1000(a). Section 1000(d) cannot apply unless there is a *transfer* of property.

The opinion of this Court in the *Rickenberg* case is conclusive that a conversion of community property into the separate property of the husband and wife does *not* involve a transfer of property. As this Court stated (177 F.2d 116-117):

> "The substance of the transaction between decedent and petitioner was that decedent relinquished his power of management and control over petitioner's share of the property. Petitioner acquired the power to manage and control her one-half and to do with it what she pleased. Decedent, likewise, acquired this same power over his one-half. *Neither decedent nor the petitioner received or gave up any property; both owned one-half before and after the agreement was executed.*
>
> * * * * * * *
>
> Since this power of management is not an interest in the property, the Commissioner and the Tax Court were in error in holding there had been a transfer of property * * *" (emphasis supplied).

The *Rickenberg* case also disposes of petitioner's assertion that sections 1000(d) and 811(d)(5) indicate a Congressional purpose to treat the spouse to whom community property was economically attributable as the owner of such community property for all gift and estate tax purposes. There is not the faintest suggestion in the language of sections 1000(d) or 811(d)(5) to support petitioner's interpretation of Congress' intent, and, as this Court stated in the *Rickenberg* case, the framework of the community property amendments of the Revenue Act of

1942 demonstrate that Congress understood that a conversion of community property was *not* a transfer of property which would bring into operation sections 1000(d) and 811(d)(5).

That Congress did not regard the term "transfer of property" to include conversions of community property is clear, also, from the 1942 gift tax amendment with respect to powers of appointment. Prior to the enactment of the Revenue Act of 1942, neither conversions of community property nor the release or exercise of powers of appointment were subject to gift tax.[3] Section 452 of that Act added section 1000(c) to the Code to specifically provide that an exercise or release of a power of appointment "*shall be deemed a transfer of property* by the individual possessing such power." Section 1000(d) immediately follows section 1000(c) in the Revenue Act of 1942. Unlike section 1000(c), however, section 1000(d) does not provide that partitions of community property shall be deemed to be transfers of community property. The conclusion is inescapable that Congress in 1942 intended *not* that conversions of community property would constitute taxable gifts but that when there *was* a gift of community property section 1000(d) would determine the person to whom such gift was taxed.[4]

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[3]Petitioner concedes that conversions of community property prior to 1943 were not subject to gift tax (R. 50. 67), and he has acquiesced in decisions holding that the exercise of release of powers of appointment prior to the effective date of the Revenue Act of 1942 were not taxable gifts (*Edith Evelyn Clark* (1942) 47 B.T.A. 865; *Mabel F. Grasselli* (1946) 7 T.C. 255).

[4]It cannot be contended that this deliberate difference in phraseology between section 1000(c) and section 1000(d) (secs. 452 and 453 of the Revenue Act of 1942) was inadvertent, and that Congress meant the same thing in the two sections. This is apparent from

As in the *Rickenberg* case, petitioner relies heavily, with lengthy quotations (Petnr. Br., pp. 31-34), upon an elaborate theory evolved by Mr. Randolph Paul (Federal Estate and Gift Taxation, 1946 Supp., pp. 210-211, 719-721) to supply the missing congressional intent. The decision in the *Rickenberg* case, of course, disposes completely of the Paul theory, which fails to consider any of the controlling factors recognized by the court in the *Rickenberg* case and reviewed above. That the Paul theory is an irrational interpretation of the statute, as well as unsound from the revenue standpoint, is demonstrated in detail by Brown and Sherman in their article "Divisions of Community Property as Taxable Gifts" (22 Calif. State Bar Journal 122), in which the authors show from a careful analysis of the statute and legislative history that such divisions are not subject to gift tax under section 1000(d).

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the provisions of section 403 of the Revenue Act of 1942, which amended section 811(f) of the Internal Revenue Code to provide that the value of property with respect to which the decedent has at the time of his death a power of appointment shall be included in his gross estate. Section 403(b) provided that if the power of appointment was exercised in favor of a public, charitable or religious use as specified in section 812(d) of the Code, then the exercise of the power would be considered a bequest of the decedent. A provision similar to section 403(b) was unnecessary in section 452 because the latter section specified that exercises and releases of powers of appointment were to be deemed transfers of property, and a charitable deduction with respect to transfer of property by gift already was provided in section 1004(a)(2) of the Code. Under the estate tax provisions such exercises and releases of powers of appointment are not transfers of property; because, if they were transfers, section 403(b) would be unnecessary in that under section 812(d) "The amount of all bequests, legacies, devises, or *transfers*" to public, charitable, and religious use shall be deducted from the gross estate in determining the net estate. This difference in wording is expressly recognized in the Committee Reports (House Report No. 2333, 77th Cong., 1st Sess., C.B. 1942-2, 372, 495, 496; Senate Report No. 1631, 77th Cong. 2d Sess., C.B. 1942-2, 504, 682) and hence cannot be attributed to inadvertence.

Finally, as the Tax Court pointed out, section 1000(d) is predicated upon the existence of a gift. Under its own terms it specifically relates to and is based upon "all *gifts* of property held as community property." As stated above, there is no question—and petitioner concedes (Tr. 50, 67)—that a conversion of community property prior to the enactment of section 1000(d) did not constitute a taxable gift. The Tax Court analyzed the effect of section 1000(d) with simple eloquence when it said in the instant case (Tr. 69):

> "It applies only *when* there is a gift of property. The section nowhere defines nor attempts to change or impose any new meaning of the word 'gift.' What constituted a gift before its enactment remained the same after it became law. The only change that it made in the Federal gift tax law was to decree that *when* a 'gift of community property' was made it 'shall be considered to be the gift of the husband.' "

(b) Even if a conversion of community property into the separate property of the spouses were to be considered a transfer, it nevertheless would not be a transfer by way of gift.

Section 1002, which was in no way amended or modified by section 1000(d), provides that a transfer of property is not subject to gift tax if it is made for an adequate and full consideration in money or money's worth. Even if a conversion of community property into the separate property of the spouses were to be considered a transfer of property, it could not be a taxable gift, because such transfer would be for an adequate and full consideration within the meaning of section 1002. While this Court in the *Rickenberg* case found it unnecessary to consider this question because it held that no transfer of property re-

sults from a conversion of community property, the opinion makes clear that the community property interests of the spouses are equal and existing. Therefore, if in a partition of community property, the husband were considered to have transferred property to the wife, then likewise the wife would be considered to have transferred property to the husband and the property received by each on the transfers, being equal, would constitute an adequate and full consideration in money or money's worth. This point is elaborately covered by the *amici curiae* briefs filed in the *Rickenberg* case, to which, in order to avoid repetition, we respectfully refer this Court.[5]

(c) The marital deduction provisions of the Revenue Act of 1948 do not indicate that section 1000(d) is applicable to conversions of community property.

Petitioner asserts that the marital deduction provisions of the Revenue Act of 1948 indicate that Congress regarded conversions of community property occurring during the effective period of section 1000(d) as having constituted taxable transfers under that section (App. Br., pp. 27-30).[6] He explains the *exclusion* from the estate and gift tax marital deduction bases of separate property obtained by a partition of community property occurring during 1942 or subsequent to April 2, 1948, and the *inclusion* of separate property obtained by such a partition occurring prior to April 2, 1948, except during 1942 (I.R.C., secs. 812(e)(2)(C)(i) and 1004(a)(3)(F)(iii)),

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[5]What constitutes full and adequate consideration under section 811(c) is the same under section 1002 (*Merrill v. Fahs* (1945) 324 U.S. 308).

[6]Petitioner made the same assertion in his petition for certiorari in the *Rickenberg* case, which was denied by the Supreme Court on February 6, 1950 (..... U.S. .....).

by the theory that in the first case the partition of community property was not subject to gift tax, but that in the latter case, Congress thought that a partition of community property was taxable under section 1000(d) (App. Br., p. 29); in other words, that Congress drew the line between inclusion in and exclusion from the marital deduction bases on the basis of gift tax liability. That the congressional demarcation followed no such line is apparent from the express language of the statutes. Both sections 812(e)(2)(C)(i) and 1004(a)(3)(F)(iii) clearly provide that separate property obtained by a partition of community property occurring *prior* to 1942 —when, as petitioner concedes (supra, p. 8), *no* gift tax liability attached to a partition of community property— is *includable* in the estate and gift tax marital deduction bases. If the congressional purpose had been as petitioner asserts, then separate property obtained by a partition of community property occurring prior to 1942 would have been *excluded* from the estate and gift tax marital deduction bases. That Congress did not so provide demonstrates that petitioner's theory as to the basis of demarcation in the Revenue Act of 1948 cannot stand analysis.

Furthermore, there is nothing in the language of the Revenue Act of 1948 or in the Committee Reports on that Act to support the Commissioner's theory that Congress regarded section 1000(d) as imposing a gift tax upon a conversion of community property into separate property. Neither section 812(e)(2)(C)(i) nor section 1004 (a)(3)(F)(iii) defines a conversion of community property as a transfer of an interest in property by one spouse

to another. The language of these sections and the lack of any suggestion in the Committee Reports indicating that Congress regarded section 1000(d) as applicable to conversions of community property demonstrate that the Commissioner's theoretical implications are without foundation. Petitioner's search for statutory language to support his contention results in a misstatement of the provisions of section 1004(a)(3)(F)(iii). On pages 27 and 28 of his brief petitioner states:

> "Congress amended Section 1004 of the Code so as by Subsection (a)(3)(F)(iii) of that section to provide for the *exclusion* from the gift tax base, for the purpose of computing the marital deduction, only of conversions of community property *between the donor and the donee spouse*—mark these words—which occurred both prior to and after the period during which Section 1000(d) was effective."

The emphasis on the words "between the donor and the donee spouse" is apparently intended to suggest that these words were used by Congress with reference to a conversion of community property. The fact is, however, that section 1004(a)(3)(F)(iii) used the words "donor and the donee spouse" with reference to a gift of *separate* property from one spouse to another. A gift of separate property of course is subject to gift tax and obviously gives rise to a donor-donee relationship. Section 1004(a)(3)(F)(iii) is concerned with whether the marital deduction is applicable to such a gift. It provides that if the *separate* property which is given was previously obtained by a conversion of community property between the spouses—that is, the "donor and donee spouse"—during 1942 or subsequent to April 2, 1948, then no marital

deduction is allowable. Obviously the words "donor" and "donee" are used to describe the relationship between the spouses with respect to the gift of *separate* property and not with respect to the prior conversion of community property.

The sentence from petitioner's brief quoted above also suggests that all conversions of community property both prior to and subsequent to the effective period of section 1000(d) are excluded from the marital deduction base. We have pointed out that this is not true. Conversions of community property prior to 1942—and, obviously, prior to the effective period of section 1000(d)—are *not* excluded from the marital deduction base.

In any event, whatever theoretical implications the Commissioner may draw from the provisions of the Revenue Act of 1948, they can have no bearing upon a determination of what transactions are covered by section 1000(d). It is an established rule that subsequent legislation cannot operate by implication to change retroactively the plain meaning of a prior statute.

Gemsco, Inc. v. Walling (1945) 324 U.S. 244, 265;

Pampanga Mills v. Trinidad (1929) 279 U.S. 211, 218;

United States v. Stafoff (1923) 260 U.S. 477, 480;

Levindale Lead Co. v. Coleman (1916) 241 U.S. 432, 439;

Jordan v. Roche (1913) 228 U.S. 436, 445;

Koshkonong v. Burton (1881) 104 U.S. 668, 677-679;

United States v. O'Connell (2 Cir. 1948) 165 F.2d 697, 699, certiorari denied (1948) 333 U.S. 864;

Suwannee Fruit & Steamship Co. v. Fleming (Emerg. Ct. of App. 1947) 160 F.2d 897, 901;
Loughman v. Town of Pelham, Westchester County, N.Y. (2 Cir. 1943) 139 F.2d 989, 993-994; cert. den. (1944) 322 U.S. 727.

For the reasons stated above, we submit that the equal allocation of community property in the years 1943, 1944 and 1945 to the taxpayer and his wife as their separate property did not constitute a taxable gift within the meaning of section 1000(d) of the Internal Revenue Code and that the provisions of section 86.2 of Treasury Regulations 108 purporting to impose a gift tax upon such a transaction are invalid as an unwarranted enlargement of the statute.

II.

THE AGREEMENT OF JANUARY 1, 1939, BETWEEN THE TAXPAYER AND HIS WIFE EFFECTIVELY CAUSED THE FUTURE EARNINGS OF THE TAXPAYER TO BE ONE-HALF HIS SEPARATE PROPERTY AND ONE-HALF THE SEPARATE PROPERTY OF HIS WIFE, SO THAT THE EARNINGS NEVER WERE COMMUNITY PROPERTY DURING THE TAXABLE YEARS IN QUESTION, BUT WERE SEPARATE PROPERTY WHEN AND AS EARNED.

As an alternative ground of supporting the judgment of the Tax Court, we submit that the court was in error when it found that the agreement of January 1, 1939, between the taxpayer and his wife did not include or relate to the future salary and earnings of the taxpayer (Tr. 62), and thus had the effect of rendering the taxpayer's earn-

ings the separate property of each spouse at the instant of acquisition.

The only evidence received in the court below, other than the stipulation of facts, was the oral testimony of the taxpayer, Mr. Mills. He testified that the terms of the oral agreement entered into on or about January 1, 1939, were that he would divide his salary and director's fees with his wife, and that one half of this compensation would be her separate property and one half would be his separate property (Tr. 33, 34). The agreement was to continue "for the rest of our lives" (Tr. 34). "It was a final settlement between us" (Tr. 37). Contrary to petitioner's allegations in his brief (pp. 12-16), there was nothing indefinite about the terms of the agreement. Quite naturally, after a lapse of over eight years, the taxpayer could not remember the exact words used. Indeed, the Tax Court might have had good reason to be suspicious if Mr. Mills had claimed to remember verbatim the conversation between his wife and himself eight years before. But there is no doubt from the testimony in the transcript as to the substance of the agreement.

Petitioner's contention that thoughts of tax consequences were the motivating force behind the decision to enter into the agreement has no merit. There is no evidence as to just how the agreement would affect Mr. Mills' tax problems, but it is certain that he was not concerned with a gift tax in the future for it was not until October 21, 1942, nearly four years after the agreement was made, that the Revenue Act of 1942, creating section 1000(d), became law.

In such a case, where the evidence is uncontradicted and the witnesses unimpeached, the court below was in error in disregarding the testimony of Mr. Mills. The rule laid down by the Supreme Court of the United States is that a trier of fact is not at liberty, under the guise of passing on the credibility of a witness, to disregard his testimony, when from no reasonable point of view it is open to doubt.

Chesapeake & Ohio Ry. v. Martin (1931) 283 U.S. 209, 214-220;

Kansas City So. Ry. v. Albers Comm. Co. (1912) 223 U.S. 573, 595, 596.

In *Twentieth Century-Fox Film Corp. v. Dieckhaus* (8 Cir. 1946) 153 F.2d 893, certiorari denied 329 U.S. 716, the plaintiff-appellee alleged that the appellant had plagiarized her unpublished book and had used it in a very successful motion picture. The district court found for the plaintiff after comparing her book with the picture, although appellant had introduced testimony to the effect that there was no copying of the plaintiff's book nor even any access thereto. The Eighth Circuit Court of Appeals reversed, holding flatly that the district court was not free to disregard this uncontradicted direct testimony, saying (pp. 899-900):

> "Although our circuit has not had occasion to declare the law in cases involving plagiarism, it is thoroughly committed upon mature consideration to the doctrine that the law does not permit the oath of credible witnesses testifying to matters within their knowledge to be disregarded because of suspicion that they may be lying. There must be impeachment of such witness or substantial contradiction, or, if the circumstances raise doubts, they must be inconsistent with the positive sworn evidence on the exact point.

> The most that can be claimed for the result of the comparison between the book and the picture in this case is that it raises a doubt or suspicion that defendant might have had access. The suspicion cannot stand against the oaths of the witnesses who know the facts. We denied power in the fact finding body to find in disregard of this settled law. American Smelting & R. Co. v. National Labor Relations Board, 8 Cir., 126 F.2d 680, loc.cit. 688. See also Chesapeake & O. R. Co. v. Martin, 283 U.S. 209, 216, 217, 51 S.Ct. 453, 75 L.Ed. 983; Cf. Massachusetts Protective Assn. v. Mouber, 8 Cir., 110 F.2d 203, 206, 207."

As shown by that case, the rule goes even to the extent that inferences from circumstantial evidence may not be drawn where they conflict with uncontradicted and unimpeached testimony:

> *Penna. R. Co. v. Chamberlain* (1933) 288 U.S. 333, 340, 341;
>
> *Texas Co. v. Hood* (5 Cir. 1947) 161 F.2d 618, 620, certiorari denied 332 U.S. 829.

In *Stone v. Stone* (App. D.C. 1943) 136 F.2d 761, the plaintiff's testimony was uncontradicted, unimpeached and not inherently improbable. In reversing the court below for finding contrary to this testimony, the Court of Appeals for the District of Columbia said (p. 764):

> "In this case there was positive testimony, uncontradicted, and not inherently improbable. Neither a jury nor a judge is at liberty to disregard such evidence. '* * * where the testimony is all one way, and is not immaterial, irrelevant, improbable, inconsistent, contradicted, or discredited, such testimony cannot be disregarded or ignored by judge or jury, and if one or the other makes a finding which is contrary to

such evidence, or which is not supported by it, an error results, for which the verdict or decision, if reviewable, must be set aside. To hold otherwise would vest triers of the facts in cases subject to review with authority to disregard the rules of evidence which safeguard the liberty and estate of the citizen. Kelly v. Jackson, 6 Pet. 622, 631, 8 L.Ed. 523.' "

See also:

San Francisco Ass'n for the Blind v. Industrial Aid (8 Cir. 1946) 152 F.2d 532;

Riggle v. Janss Inv. Corporation (9 Cir. 1937) 88 F.2d 111, 116;

Biddle v. Commissioner of Internal Revenue (2 Cir. 1936) 86 F.2d 718;

Alabama Title & Trust Co. v. Millsap (5 Cir. 1934) 71 F.2d 518, 520.

Since the terms of the agreement described by the taxpayer are nowhere contradicted, and the record is clear that the agreement was conscientiously performed as made (Stip. par. 7, 8; R. 45-48), the petitioner's suggestion that it may have been motivated by thoughts of tax consequences is irrelevant. The question is *what* was done, not *why* it was done, and we have completely answered the question by showing the terms and performance of the agreement. As this Court said in one of the cases upon which the Commissioner relies, *Brunton v. Commissioner of Internal Revenue* (9 Cir. 1930) 42 F.2d 81, 82:

"It is to be conceded that the contract is not to be deemed ineffectual merely because the purpose of the decedent may have been to avoid the heavier tax rate of 1921" (citations omitted).

Consequently, the rule that the Court is not bound by an interested party's declaration of purpose is inapplicable, and, likewise, the cases cited by petitioner on pages 14 and 15 have no application to the instant case.[7]

This Court has repeatedly held that under California law an agreement between a husband and wife changing the status of community property to separate property has the effect of rendering future earnings of the spouses separate property from the instant of acquisition. The earnings in such a case never become community property.

O'Bryan v. Commissioner of Internal Revenue (9 Cir. 1945) 148 F.2d 456, 458;

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[7]*Helvering v. National Grocery Co.* (1938) 304 U.S. 282; *Helvering v. Chicago Stockyards Co.* (1943) 318 U.S. 693; *William C. de Mille Productions, Inc.* (1934) 30 B.T.A. 826; *Reynard Corporation* (1938) 37 B.T.A. 552; *R. L. Blaffer & Co.* (1938) 37 B.T.A. 851; and *W. S. Farish & Co.* (1938) 38 B.T.A. 150, concerned the surtax on corporations improperly accumulating surplus, now section 102 of the International Revenue Code. In such cases the motive for accumulating the surplus is made by statute a critical factor in determining whether the tax shall be imposed. *Schoenberg v. Commissioner of Internal Revenue* (8 Cir. 1935) 77 F.2d 446; *Rand v. Helvering* (8 Cir. 1935) 77 F.2d 450; *Harold F. Seymour* (1932) 27 B.T.A. 403; *Joseph W. Powell* (1936) 34 B.T.A. 655, were cases involving "wash sales," in which the nature of the transaction is inherently suspicious and the taxpayer's purpose for that reason is a critical factor in determining the true substance of the transaction. Furthermore, in the *Rand* case, supra, the uncontradicted evidence was so highly improbable that the court was not required to give it any weight. *Texas & New Orleans Railroad Co. v. Brotherhood of Railway and Steamship Clerks* (1930) 281 U.S. 548, was a labor case, in which motive is material to determine the question of good faith. *United States v. Washington Dehydrated Food Co.* (8 Cir. 1937) 89 F.2d 606, was a case of conflicting testimony where the Government contended the finding was against the weight of the evidence, which is not a reviewable error. In *Stone v. United States* (1896) 164 U.S. 380, the transcript of the evidence was not before the Court, so that it could not review the sufficiency of the evidence.

Jurs v. Commissioner of Internal Revenue (9 Cir. 1945) 147 F.2d 805, 810;

Hardy v. Commissioner of Internal Revenue (9 Cir. 1942) 125 F.2d 863;

Sommerville v. Commissioner of Internal Revenue (9 Cir. 1941) 123 F.2d 975;

Van Dyke v. Commissioner of Internal Revenue (9 Cir. 1941) 120 F.2d 945, 947;

Boland v. Commissioner of Internal Revenue (9 Cir. 1941) 118 F.2d 622, 624;

Sparkman v. Commissioner of Internal Revenue (9 Cir. 1940) 112 F.2d 774, 776, 777;

Van Every v. Commissioner of Internal Revenue (9 Cir. 1940) 108 F.2d 650, certiorari denied 309 U.S. 689;

Helvering v. Hickman (9 Cir. 1934) 70 F.2d 985.

The Court of Claims also has laid down the rule that an agreement between the spouses changing the status of their future earnings from community to separate property will be given effect for tax purposes.

Claire v. United States (Ct.Cl. 1940) 34 F.Supp. 1009, 1013;

Marshall v. United States (Ct.Cl. 1939) 26 F.Supp. 474, 479, certiorari denied 308 U.S. 597.

Thus the effect of the agreement between the taxpayer and his wife on January 1, 1939, was to constitute one half the earnings of the taxpayer the separate property of his wife, and those earnings never became, even for an instant, community property.

The fact that the source of the income was the earnings of the taxpayer does not require the conclusion that he made a taxable gift in the years in question.

Cf. *Commissioner of Internal Revenue v. Hogle* (10 Cir. 1947) 165 F.2d 352.

In the *Hogle* case the taxpayer was the settlor and trustee of a trust of the Clifford type, and the Tenth Circuit Court of Appeals had previously determined that the income from the trust resulting from trading in securities and commodities under the taxpayer's direction was taxable to the settlor because it was within his power to control the extent of such trading and therefore the amount of income (*Hogle v. Commissioner of Internal Revenue* (10 Cir. 1942) 132 F.2d 66). Nevertheless, in the second *Hogle* case, wherein the Commissioner sought to impose a gift tax on the income received by the beneficiaries the Court held that no gift tax was payable because there was no transfer of any property to the beneficiaries by the settlor. The trust was irrevocable, and no right to alter or amend was retained. Hence, the beneficiaries had an absolute right to the income, not dependent upon any act of the settlor. There was no transfer directly or indirectly from the settlor to the trust of the income from the securities.

The analogy between the second *Hogle* case, 165 F.2d 352, and the instant case is clear. The effect of the 1939 agreement between the taxpayer and his wife was to render one half of his future earnings her separate property. Nothing he could do, once the income was earned, could divest her of her interest.

The contention of the Commissioner that the principle of *Lucas v. Earl* (1930) 281 U.S. 111, requires the im-

position of the gift tax misses the point. If one half the earnings of the husband are the separate property of the wife, this must be so because of the 1939 agreement. The mere fact that checks were deposited in the wife's account would not make the money any less community property. The only evidence of any agreement to change the character of the property is that of the 1939 agreement, testified to by the taxpayer. If the taxpayer's earnings did not become separate property by virtue of that agreement, they did not become separate property at all, and if they did not become separate property, no gift tax can possibly be due.

CONCLUSION.

For the reasons stated above the decisions of the Tax Court should be affirmed.

March 15, 1950.

Respectfully submitted,

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(Appendix Follows.)

Appendix

Internal Revenue Code:

SEC. 811. GROSS ESTATE.

The value of the gross estate of the decedent shall be determined by including the value at the time of his death of all property, real or personal, tangible or intangible, wherever situated, except real property situated outside of the United States—

* * * * *

(d) *Revocable Transfers*—

* * * * *

(5) [added by Section 402(a) of the Revenue Act of 1942, c. 619, 56 Stat. 798]. *Transfers of Community Property in Contemplation of Death, etc.*—For the purposes of this subsection and subsection (c), a transfer of property held as community property by the decedent and surviving spouse under the laws of any State, Territory, or possession of the United States, or any foreign country, shall be considered to have been made by the decedent, except such part thereof as may be shown to have been received as compensation for personal services actually rendered by the surviving spouse or derived originally from such compensation or from separate property of the surviving spouse.

f(1) In General.—To the extent of any property (A) with respect to which the decedent has at the time of his death a power of appointment, or (B) with respect to which he has at any time exercised or re-

leased a power of appointment in contemplation of death, or (C) with respect to which he has at any time exercised or released a power of appointment by a disposition intended to take effect in possession or enjoyment at or after his death, or by a disposition under which he has retained for his life or any period not ascertainable without reference to his death or for any period which does not in fact end before his death (i) the possession or enjoyment of, or the right to the income from, the property, or (ii) the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom; except in case of a bona fide sale for an adequate and full consideration in money or money's worth.

(26 U.S.C. 1946 ed., Sec. 811.)

SEC. 1000. IMPOSITION OF TAX.

(a) For the calendar year 1940 and each calendar year thereafter a tax, computed as provided in section 1001, shall be imposed upon the transfer during such calendar year by any individual, resident or nonresident, of property by gift. Gift taxes for the calendar years 1932-1939, inclusive, shall not be affected by the provisions of this chapter, but shall remain subject to the applicable provisions of the Revenue Act of 1932, except as such provisions are modified by legislation enacted subsequent to the Revenue Act of 1932.

* * * * *

(c) Powers of Appointment.—An exercise or release of a power of appointment shall be deemed a transfer

of property by the individual possessing such power. For the purposes of this subsection the term "power of appointment" means any power to appoint exercisable by an individual either alone or in conjunction with any person, except—

(1) a power to appoint within a class which does not include any others than the spouse of such individual, spouse of the creator of the power, descendants of such individual or his spouse, descendants (other than such individual) of the creator of the power or his spouse, spouses of such descendants, donees described in section 1004(a)(2), and donees described in section 1004(b). As used in this paragraph, the term "descendant" includes adopted and illegitimate descendants, and the term "spouse" includes former spouse; and

(2) a power to appoint within a restricted class if such individual did not receive any beneficial interest, vested or contingent, in the property from the creator of the power or thereafter acquire any such interest, and if the power is not exercisable to any extent for the benefit of such individual, his estate, his creditors, or the creditors of his estate.

If a power to appoint is exercised by creating another power to appoint, such first power shall not be considered excepted under paragraph (1) or (2) from the definition of power of appointment to the extent of the value of the property subject to such second power to appoint. For the purposes of the preceding sentence the value of the property subject to such second power

to appoint shall be its value unreduced by any precedent or subsequent interest not subject to such power to appoint.

(d) [as added by Section 453 of the Revenue Act of 1942, *supra*]. *Community Property.*—All gifts of property held as community property, under the law of any State, Territory, or possession of the United States, or any foreign country shall be considered to be the gifts of the husband except that gifts of such property as may be shown to have been received as compensation for personal services actually rendered by the wife or derived originally from such compensation or from separate property of the wife shall be considered to be gifts of the wife.

* * * * *

(26 U.S.C. 1946 ed., Sec. 1000.)

SEC. 1002. TRANSFER FOR LESS THAN ADEQUATE AND FULL CONSIDERATION.

Where property is transferred for less than an adequate and full consideration in money or money's worth, then the amount by which the value of the property exceeded the value of the consideration shall, for the purpose of the tax imposed by this chapter, be deemed a gift, and shall be included in computing the amount of gifts made during the calendar year.

(26 U.S.C. 1946 ed., Sec. 1002.)

Revenue Act of 1948, c. 168, 62 Stat. 110:

SEC. 361. MARITAL DEDUCTION.

(a) Section 812 of the Internal Revenue Code (relating to deductions in computing net estate in the case of a citizen or resident of the United States) is hereby amended by adding at the end thereof a new subsection to read as follows:

"(e) *Bequests, Etc., To Surviving Spouse.*—

"(1) *Allowance of Marital Deduction.*—

"(A) *In General.*—An amount equal to the value of any interest in property which passes or has passed from the decedent to his surviving spouse, but only to the extent that such interest is included in determining the value of the gross estate.

* * * * *

"(2) *Computation of Adjusted Gross Estate.*—

* * * * *

"(C) *Same—Conversion Into Separate Property.*—

"(i) If during the calendar year 1942 or after the date of the enactment of the Revenue Act of 1948, property held as such community property (unless considered by reason of subparagraph (B) of this paragraph as not so held) was by the decedent and the surviving spouse converted, by one transaction or a series of transactions, into separate property of the decedent and his spouse (including any form or co-ownership by them), the separate property so acquired by the decedent and any property acquired at any time

by the decedent in exchange therefor (by one exchange or a series of exchanges) shall, for the purposes of clauses (i), (ii), and (iii) of subparagraph (B), be considered as 'held as such community property'.

* * * * *

(26 U.S.C. 1946 ed., Supp. II, Sec. 812.)

SEC. 371. GIFTS OF COMMUNITY PROPERTY.

Section 1000 (d) of the Internal Revenue Code (relating to gifts of property held as community property) is amended by adding at the end thereof a new sentence to read as follows: "This subsection shall be applicable only to gifts made after the calendar year 1942 and on or before the date of the enactment of the Revenue Act of 1948."

(26 U.S.C. 1946 ed., Supp. II, Sec. 1000.)

SEC. 372. MARITAL DEDUCTION.

Section 1004 (a) of the Internal Revenue Code (relating to deductions in computing net gifts in the case of a citizen or resident of the United States) is hereby amended by adding at the end thereof a new paragraph to read as follows:

"(3) *Gift to Spouse.*—

"(A) *In General.*—Where the donor transfers during the calendar year (and after the date of the enactment of the Revenue Act of 1948) by gift an interest in property to a donee who at the time of the

gift is the donor's spouse—an amount with respect to such interest equal to one-half of its value.

* * * * *

"(F) *Community Property.*—

"(i) A deduction otherwise allowable under this paragraph shall be allowed only to the extent that the transfer can be shown to represent a gift of property which is not, at the time of the gift, held as community property under the law of any State, Territory, or possession of the United States, or of any foreign country.

"(ii) For the purposes of clause (i), community property (except property which is considered as community property solely by reason of the provisions of clause (iii) shall not be considered as 'held as community property' if the entire value of such property (and not merely one-half thereof) is treated as the amount of the gift.

"(iii) If during the calendar year 1942 or after the date of the enactment of the Revenue Act of 1948, property held as such community property (unless considered by reason of clause (ii) as not so held) was by the donor and the donee spouse converted, by one transaction or a series of transactions, into separate property of the donor and such spouse (including any form of co-ownership by them), the separate property so acquired by the donor and any property acquired at any time by the donor in exchange therefor (by one exchange or a series of exchanges) shall, for the purposes of

clause (i), be considered as 'held as community property'.

* * * * *

(26 U.S.C. 1946 ed., Supp. II, Sec. 1004.)

Treasury Regulations 105, promulgated under the Internal Revenue Code:

SEC. 81.15 [as amended by T.D. 5239, 1943 Cum. Bull. 1081, 1084] *Transfers during life.*— * * *

In the case of estates of decedents dying after October 21, 1942, a transfer to a third party or third parties of property held as community property by the decedent and spouse under the law of any State, Territory, or possession of the United States, or any foreign country, shall be considered, in accordance with section 811 (d)(5), as added by section 402(a) of the Revenue Act of 1942, for the purposes of this section and sections 81.16 through 81.21, inclusive, to have been made by the decedent, except such part thereof as may be shown to have been received as compensation for personal services actually rendered by the spouse or derived originally from such compensation or from separate property of the spouse. The same statutory provisions apply in the case of a division of such community property between the decedent and spouse into separate property, and in the case of a transfer of any part of the community property into separate property of such spouse; in such cases, the value of the property which becomes the separate property of such spouse, with the exception stated in the preceding sentence, shall be included in the gross estate of the decedent

under section 811 (c) or section 811 (d), if the other conditions of taxability under such sections exist. If in the case of a decedent who died after October 21, 1942, property held as community property by such decedent and his spouse is transferred to themselves as joint tenants or as tenants by the entirety, the transfer is taxable under section 811(c), except with respect to such part of the property so transferred as is attributable to the spouse under the exception stated in the first sentence of this paragraph. With respect to the meaning of property derived originally from such compensation or from separate property of the spouse and to the identification required, see section 81.23.

Treasury Regulations 108, promulgated under the Internal Revenue Code:

SEC. 86.2 *Transfers Reached.*— * * *

* * * * *

(c) *Transfers of community property after 1942.*— During the calendar year 1943 and any calendar year thereafter any gift of property held as community property under the law of any State, Territory, or possession of the United States, or any foreign country constitutes a gift of the husband for the purpose of the gift tax statute (regardless of whether under the terms of the transfer the husband alone or the wife alone is designated as the donor or whether both are so designated as donors), except to the extent that such property is shown (1) to have been received as compensation for personal services actually rendered by the wife or derived originally from such compensation, or (2) to

have been derived originally from separate property of the wife. The entire property comprising the gift is prima facie a gift of the husband, but any portion thereof which is shown to be economically attributable to the wife as prescribed in the preceding sentence constitutes a gift of the wife.

The rule stated in the preceding paragraph applies alike to a transfer by way of gift of community property to a third party or third parties, to a division of such community property between husband and wife into the separate property of each, and to a transfer by the husband and wife of any part of such community property into the separate property either of the husband or of the wife, or into a joint estate or tenancy by the entirety of both spouses. In all of such cases the value of the property so transferred or so divided, as the case may be, is a gift by the husband to the extent that it exceeds the aggregate amount of the value of that portion which is shown to be economically attributable to the wife, as prescribed in the preceding paragraph, and of the value of the husband's interest in such property after such transfer or division. The value of the property so transferred or so divided, as the case may be, is a gift by the wife to the extent that the portion of such value which is shown to be economically attributable to her, as prescribed in the preceding paragraph, exceeds the value of her interest in such property after such transfer or division. See examples (5) and (6) of subsection (a) of this section. No gift tax results from a transfer on or after January 1, 1943, of

separate property of either spouse into community property.

Property derived originally from compensation for personal services actually rendered by the wife or from separate property of the wife includes property that may be identified as (1) income yielded by property received as such compensation or by such separate property, and (2) property clearly traceable (by reason of acquisition in exchange, or other derivation) to property received as such compensation, to such separate property, or to such income. The rule established by this statute for apportioning the respective contributions of the spouses is applicable regardless of varying local rules of apportionment, and State presumptions are not operative against the Commissioner.